A REVIEW OF CREDIT AVAILABILITY IN RURAL AMERICA

HEARING

BEFORE THE

SUBCOMMITTEE ON
LIVESTOCK, RURAL DEVELOPMENT, AND CREDIT

OF THE

COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

JUNE 25, 2014

Serial No. 113–15

Printed for the use of the Committee on Agriculture
agriculture.house.gov

U.S. GOVERNMENT PRINTING OFFICE

88–547 PDF WASHINGTON : 2014

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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A REVIEW OF CREDIT AVAILABILITY IN RURAL AMERICA

WEDNESDAY, JUNE 25, 2014

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON LIVESTOCK, RURAL DEVELOPMENT, AND CREDIT,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The Subcommittee met, pursuant to call, at 10:01 a.m., in Room 1300 of the Longworth House Office Building, Hon. Eric A. "Rick" Crawford [Chairman of the Subcommittee] presiding.

Members present: Representatives Crawford, Goodlatte, King, Rogers, Conaway, DesJarlais, Yoho, Costa, Scott, Vela, Lujan Grisham, Bustos, Schrader, and Nolan.

Staff present: Caleb Crosswhite, Debbie Smith, Josh Maxwell, Kevin Kramp, Mary Nowak, Pete Thomson, Skylar Sowder, Anne Simmons, Lisa Shelton, Liz Friedlander, and Riley Pagett.

OPENING STATEMENT OF HON. ERIC A. "RICK" CRAWFORD, A REPRESENTATIVE IN CONGRESS FROM ARKANSAS

The CHAIRMAN. This hearing of the Subcommittee on Livestock, Rural Development, and Credit to review credit availability in rural America, will come to order. Good morning and thank you all for attending today's hearing to review credit availability in rural America.

Before I go any further, I do want to take a point of privilege, if you would allow, and that is to recognize Debbie Smith who is clerking her last hearing in the Agriculture Committee after 35 years of service. She began her career here on the Hill at 19 years of age, and she served seven chairmen during the span of eight farm bills. I probably said too much on the math. But let me just say, she has always made the trains run on time here in the Committee. She is a treasure that we will certainly miss dearly, especially when it comes to getting our way in conference in the Senate. So, Debbie, thank you so much. And we appreciate you.

All right. I know she would want me to go on with the show. Providing credit to America's farmers and ranchers is a necessary and serious challenge for many lenders in the United States. The Farm Credit System, commercial banks and USDA's Farm Service Agency have continued to do an outstanding job working to meet the credit needs of rural America. I believe it is important to hold hearings like the one we are holding today to make sure the credit needs of producers are being met and will continue to be met in the future.

As we know, the ag economy is highly cyclical. History teaches us that interest rates will eventually go up, and record high prices will eventually come down. In fact, after a recent period of historic highs, crop prices have declined due to record plantings and strong production, and farmland values are slightly decreasing. While livestock producers are rebounding on the balance sheet with lower feed costs, our western producers are still struggling with consecutive years of drought.

Thankfully, due to recent years of high farm incomes and responsible underwriting, the state of our ag lending institutions and the farm economy remain strong. Even though the current ag economy and higher farm prices have resulted in overall good credit conditions, we must be cautious moving forward. While farmers should see a small drop in production costs, USDA is forecasting a 27 percent decline in farm income from last year. In order to sustain an abundant supply of food and fiber well into the future, we must ensure that responsible farm and ag credit policies are in place now.

The Agricultural Act of 2014 was instrumental in doing just that. The bill included several provisions to provide opportunities for young and beginning farmers, including making permanent a microloan program to meet their needs for smaller projects and creating a cooperative lending pilot program. Additionally, the elimination of term limits on guaranteed operating loans will give borrowers and lenders the certainty they need to work together to graduate participants to commercial credit.

Today, I am pleased to welcome a distinguished group of witnesses and I look forward to learning more from them about their perspectives of current credit conditions and their forecast for the future economy of rural America.

[The prepared statement of Mr. Crawford follows:]

PREPARED STATEMENT OF HON. ERIC A. "RICK" CRAWFORD, A REPRESENTATIVE IN CONGRESS FROM ARKANSAS

Good morning. Thank you all for attending today's hearing to review credit availability in rural America.

Providing credit to America's farmers and ranchers is a necessary and serious challenge for many lenders in the United States. The Farm Credit System, commercial banks, and USDA's Farm Service Agency have continued to do an outstanding job working to meet the credit needs of rural America.

I believe it is important to hold hearings like the one today to make sure the credit needs of producers are being met and will continue to be met in the future. As we know, the agricultural economy is highly cyclical. History teaches us that interest rates will eventually go up and record high-prices will eventually come down.

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Even though the current agricultural economy and higher farm prices have resulted in overall good credit conditions, we must be cautious moving forward. While farmers should see a small drop in production costs, USDA is forecasting a 27% decline in farm income from last year.

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Today I am pleased to welcome a distinguished group of witnesses and I look forward to learning more from them about their perspectives of current credit conditions and their forecast for the future economy of rural America.

The CHAIRMAN. I would like to recognize our distinguished Ranking Member, my friend from California, Mr. Costa.

OPENING STATEMENT OF HON. JIM COSTA, A REPRESENTATIVE IN CONGRESS FROM CALIFORNIA

Mr. COSTA. Thank you very much, Chairman Crawford, ladies and gentlemen, and our good witnesses on the two panels that we will be hearing from shortly. We appreciate you being here and having the opportunity to hear from the witnesses on what we can do to ensure that farmers, ranchers and dairy producers across this great nation of ours have the necessary financial resources to continue to produce what I believe—what this entire Subcommittee believes—is the most nutritious, the finest food products grown anywhere in the world at cost levels to American consumers that cannot be matched anywhere in the world. And, certainly, it is the agricultural producers of this nation that make it happen every day.

But we are here because the certainty provided by availability of credit for our producers is a critical link for their continued prosperity and of our ability to make this happen. Despite the strength of the farm economy, we all know that there is significant volatility that occurs on a cyclical nature throughout every region of America. America's farmers, ranchers and dairy producers face so many different variables as they grow the food that we put on our dinner table each day that sadly, in my view, it is too often taken for granted by the consumers who get that wonderful food at their table. They don't understand, in many instances, the hard work and the risk-taking that is involved. Every day these variables take different shapes and forms. We are all aware of the natural disasters like droughts and floods. And despite those challenges, our producers are resilient. But they also deal with other levels of volatility in the marketplace. And, obviously, we are proud of their efforts to preserve and sustain themselves through these difficult challenges.

In my home State of California, as across much of the western United States, farmers, ranchers and dairy producers, as the Chairman noted a moment ago, are dealing with a devastating drought after 3 consecutive below average rainfall years. And couple that with water systems that today cannot meet the demands we face. In California, for example, we are looking at a 6 million acres of very highly productive agricultural land in which possibly over 600,000 acres of that 6 million acres could become fallow this year. What are the totals of those impacts and costs?

Therefore, we have to ensure that credit is available to our producers, both large and small and in between. And to ensure that credit is available, we must have the mechanisms in place, the tools, to provide producers that financial assistance. For example, the dairy producers in California and across the country saw a sharp decline in prices back in 2009 and 2010 when we were looking at $9 per hundredweight in milk prices. We had significant bankruptcies as a result of that. Farm Credit's loan portfolio was

impacted as were other private institutions that were financing dairies.

But with the passage of the new farm bill, and bipartisan credit is due to this Subcommittee and to the full Committee with both Chairman Lucas and Ranking Member Peterson, we were able to produce a 2014 Farm Bill that I think reflects a lot of the current needs that American agriculture is facing. Dairy producers, as an example, and lenders alike, will have confidence to apply for and provide loans respectively because of the new dairy title and the safety net that exists with the insurance program.

There were also other reforms that were made in the Agricultural Act of 2014 that we believe collectively bolster rural America. The microloans that were mentioned, the efforts to provide assistance to young farmers, the EQIP Program and Market Access Program, as examples, we take for granted. But American agricultural exports are at an all-time high, proving that not only can we produce the food on the American consumer's dinner table better than anywhere, but we can compete in foreign markets if we have a level playing field.

So, Mr. Chairman, I look forward to hearing what our witnesses have to say about their confidence in our agriculture economy and the attempt to ensure that we have a stable source of lending activity that is available for agriculture in every region of America, as we implement the reforms in the 2014 Farm Bill.

So thank you, and I yield back the balance of my time.

The CHAIRMAN. I thank the Ranking Member and would request that any Members that want to submit an opening statement would do so in writing for the record, so witnesses may begin their testimony and ensure that there is ample time for questions.

I would like to welcome our first panel of witnesses. Our first three witnesses, the Honorable Jill Long Thompson, Board Chair and CEO, Farm Credit Administration; Mr. Chris Beyerhelm, Deputy Administrator for Farm Loan Programs, Farm Service Agency, USDA; and Mr. Nathan S. Kauffman, Assistant Vice President, Federal Reserve Bank of Kansas City, Omaha Branch, Omaha, Nebraska. We appreciate the witnesses being here today.

We will recognize each of you in turn for 5 minutes. I would direct your attention to the timer and the box that you see in front of you. If the light is green, it means you are good to go. If it turns yellow, it is just like when you are in your car, you might want to step on the gas because it is fixing to turn red. So we appreciate that.

And with that, I would like to introduce our first witness, the Honorable Jill Long Thompson. You are recognized for 5 minutes.

STATEMENT OF HON. JILL LONG THOMPSON, PH.D., BOARD CHAIR AND CHIEF EXECUTIVE OFFICER, FARM CREDIT ADMINISTRATION, MCLEAN, VA

Dr. LONG THOMPSON. Thank you, Mr. Chairman, Members of the Subcommittee. I am Jill Long Thompson, Board Chair——

The CHAIRMAN. Can you turn on the microphone. Thank you, ma'am.

Dr. LONG THOMPSON. Thank you. That is better. Mr. Chairman and Members of the Subcommittee, I am Jill Long Thompson,

Board Chair and Chief Executive Officer of the Farm Credit Administration. On behalf of my colleagues on the FCA Board, Kenneth Spearman and Leland Strom, and the dedicated women and men at FCA, I am pleased to participate in this hearing today.

As required by the Farm Credit Act of 1971, as amended, FCA serves as the independent arm's-length agency responsible for examining and regulating the banks, associations and related entities of the Farm Credit System. We take our responsibilities very seriously, and we strive to interpret the Farm Credit Act faithfully.

Congress established the Farm Credit System in 1916 to provide American agriculture with a dependable source of credit. The System consists of a nationwide network of cooperatively organized banks and associations that are owned and controlled by their borrowers. It serves all 50 states and the Commonwealth of Puerto Rico. At year-end 2012, the System held more than 46 percent of the nation's farm real estate debt. And I am pleased to report that the System's overall condition and performance remains sound, and it continues to fulfill its Congressionally mandated mission.

The System's net income was $4.64 billion in 2013, up 12.7 percent from 2012. Since 2010 when the financial crisis and recession were in full swing, credit quality has continued to improve. As of December 31, 2013, non-performing loans amounted to $2 billion, or 1.01 percent of gross loans, down from $2.6 billion or 1.36 percent at year-end 2012.

Because the System raises the money it lends to borrowers by selling securities in the debt markets, having reliable access to debt capital is critical for the System. And I am happy to report that it continues to experience reliable access. And investor demand for all System debt security products is strong.

In addition to monitoring the Farm Credit System, my agency closely monitors the farm economy for emerging risks that would affect farmers and their lenders. Currently, U.S. agriculture, as a whole, remains strong. In the Farm Credit Act, Congress requires System institutions to provide programs specifically to serve young, beginning and small, or as we call them YBS farmers and ranchers. In our examinations of System institutions, we review their YBS programs to ensure that they are meeting the needs of these borrowers. And we also require annual reports from institutions on their YBS lending activities.

In the wake of the global financial crisis, we have undertaken two major rulemaking actions to strengthen the safety and soundness of System institutions. Last June, we issued a revised liquidity regulation requiring each bank to maintain higher quality liquidity, as well as a supplemental liquidity buffer. The rule helps ensure that System banks keep liquidity to continue operating if their access to the capital markets is temporarily interrupted.

In addition, the FCA staff worked throughout 2013 and into 2014 on extensive revisions to the agency's capital regulations. The proposed rule, which the Board adopted last month, would modernize our capital requirements while ensuring that System institutions continue to hold regulatory capital to fulfill their mission.

Another part of our mission is to regulate and oversee the Federal Agricultural Mortgage Corporation, or as it is known Farmer Mac. Congress established Farmer Mac in 1988 to provide a sec-

ondary market for agricultural mortgage and rural home loans to improve the availability of cost effective, long-term credit and liquidity to America's farmers, ranchers and rural communities. Farmer Mac is in good financial condition and continues to grow its operations and risk bearing capacity to advance its statutory mission.

In the past couple of years, as our nation has considered the ways corporate misconduct may have contributed to the recent financial crisis, my agency has increased its emphasis on ethics and standards of conduct, both among our own employees and in the institutions we regulate. American agriculture is critical to meeting the food demands of this nation and the world, and the Farm Credit System is a critical source of financing for America's farmers and ranchers. As the regulator of the System, FCA is committed to helping maintain the source for generations to come.

And, Mr. Chairman, this concludes my statement. But, of course, I will be happy to answer any questions you may have.

[The prepared statement of Dr. Long Thompson follows:]

PREPARED STATEMENT OF HON. JILL LONG THOMPSON, PH.D., BOARD CHAIR AND CHIEF EXECUTIVE OFFICER, FARM CREDIT ADMINISTRATION, MCLEAN, VA

Introduction

Chairman Crawford, Ranking Member Costa, Members of the Subcommittee, I am Jill Long Thompson, Board Chair and Chief Executive Officer of the Farm Credit Administration (FCA or Agency). On behalf of my colleagues on the FCA Board, Kenneth A. Spearman of Florida, Leland A. Strom of Illinois, and all the dedicated men and women of the Agency, I am pleased to participate in this hearing today.

FCA is an independent agency responsible for examining and regulating the banks, associations, and related entities in the Farm Credit System (FCS or System), including the Federal Agricultural Mortgage Corporation (Farmer Mac). The banks and associations of the FCS form a nationwide network of borrower-owned financial institutions that provide credit to farmers, ranchers, residents of rural communities, agricultural and rural utility cooperatives, and other eligible borrowers.

FCA Mission

As directed by Congress, FCA's mission is to ensure a safe, sound, and dependable source of credit and related services for agriculture and rural America. We accomplish this mission in two important ways.

First, we protect the safety and soundness of the FCS by examining and supervising all FCS institutions, including Farmer Mac, and we ensure that they comply with applicable laws and regulations. Our examinations and oversight strategies focus on an institution's financial condition and any material existing or potential risk, as well as on the ability of its board and management to direct its operations. We also evaluate each institution's compliance with laws and regulations to ensure that it serves all eligible borrowers, including young, beginning, and small farmers and ranchers. If a System institution violates a law or regulation or operates in an unsafe or unsound manner, we use our supervisory and enforcement authorities to take appropriate corrective action.

Second, we develop policies and regulations that govern how System institutions conduct their business and interact with customers. Our policies and regulations protect System safety and soundness; implement the Farm Credit Act; provide minimum requirements for lending, related services, investments, capital, and mission; and ensure adequate financial disclosure and governance. We approve the corporate charter changes of System institutions, System debt issuance, and other financial and operational matters.

Through the oversight and leadership of the House and Senate Agriculture Committees, many important reforms were made to the Farm Credit Administration and the FCS as a result of the agricultural credit crisis of the 1980s. This included restructuring FCA as an independent arm's-length regulator with formal enforcement powers, providing borrower rights to System borrowers with distressed loans, and

establishing the Farm Credit Insurance Fund (Insurance Fund) to protect System investors.

Since then, the Farm Credit System has restored its financial health and the public trust. Using our authority as an arm's-length regulator, we have contributed to the System's success by ensuring that System institutions adhered to safety and soundness standards. The Insurance Fund also helped by restoring investor confidence.

Both the System and FCA learned much during the crisis of the 1980s, and those lessons helped build a much stronger Farm Credit System, as well as a stronger regulator. We will continue to focus on ensuring that the System remains safe and sound by promulgating regulations, providing appropriate guidance, and maintaining strong and proactive examination and supervisory programs. With the dynamics and risks in the agricultural and financial sectors today, we recognize that FCS institutions must have the appropriate culture, governance, policies, procedures, and management controls to effectively identify and manage risks. Today the System is a dependable provider of credit to agriculture and rural America as intended by Congress.

Farm Credit System Mission

The FCS is a government-sponsored enterprise (GSE) created by Congress in 1916 to provide American agriculture with a dependable source of credit. The System's banks and associations form a nationwide network of cooperatively organized banks and associations that are owned and controlled by their borrowers, serving all 50 states and the Commonwealth of Puerto Rico.

The System provides credit and other services to agricultural producers and farmer-owned agricultural and aquatic cooperatives. It also makes loans for agricultural processing and marketing activities, rural housing, farm-related businesses, rural utilities, and foreign and domestic companies involved in international agricultural trade. In addition, the System provides funding and discounting services to certain "other financing institutions" and forms partnerships with commercial banks to provide credit to agriculture and rural America through participations and syndications.

As required by law, System borrowers own stock or participation certificates in System institutions. The FCS had nearly 1.1 million loans and approximately 500,000 stockholders in 2013. Approximately 85 percent of the stockholders were farmers or cooperatives with voting stock. The remaining 15 percent were nonvoting stockholders, including rural homeowners and other financing institutions that borrow from the System. The U.S. Department of Agriculture's latest data show that the System's market share of farm debt was 41 percent, which slightly exceeds the 40 percent share held by commercial banks.

One of FCA's oversight roles is to ensure that the System, with its mission devoted to agriculture and rural America, maintains its presence in the agricultural marketplace to provide competitive and dependable credit for all eligible and creditworthy farmers, ranchers, and agricultural cooperatives. In fact, the System has maintained its mission service during the difficult markets of the past 6 years to help producers and rural America. When commodity prices soared in early 2008, System institutions stepped forward to meet the critical financing needs of the grain elevator industry. They met increased demands for financing machinery and higher input costs for producers. The FCS also helped Midwest borrowers affected by floods and worked with livestock producers, especially dairy and hog producers, as they made difficult decisions during stressful market conditions. Overall the System continued to have access to funds and was able to increase its lending to agriculture and rural America during a financial crisis and severe recession.

Condition of the FCS

The FCS remains fundamentally safe and sound and is well positioned to withstand the challenges facing agriculture. Although the near-term outlook for agriculture is generally favorable, uncertainty surrounding both the general and farm economies will present continuing challenges for the System.

The U.S. Department of Agriculture is projecting that net cash income will drop sharply in 2014. Crop prices declined significantly in 2013 in response to strong global crop production. Near-record U.S. corn and soybean plantings and a return to normal yields in 2014 could lead to further declines in grain and oilseed prices.

As a consequence of lower prices, margins for crop producers will be sharply lower, but the dairy and livestock sectors should see a significant improvement in profitability. Lower grain prices are also having a cooling effect on the farmland market, especially in the Midwest. Severe drought conditions in the West, especially in California, may also negatively affect System borrowers. While the current credit

stress level in the System's loan portfolio is well within its risk-bearing capacity, the above-mentioned factors may adversely affect asset quality in 2014.

The System continues to grow at a moderate pace. As of March 31, 2014, gross loans totaled $204.6 billion, up $12.8 billion or 6.7 percent from March 31, 2013. Real estate mortgage lending was up $5.5 billion or 6.2 percent as demand for cropland continued in 2013, especially in the Midwest. Overall, real estate mortgage loans represent 46.1 percent of the System's loan portfolio. Agribusiness and production lending increased by $3.3 billion from the year before, and intermediate-term lending increased by $2.4 billion.

The System also continues to enhance its capital base. As of March 31, 2014, System capital equaled $43.7 billion, up from $39.6 billion the year before. The System's total capital-to-assets ratio was 16.6 percent as compared with 16.0 percent a year earlier. Moreover, more than 81 percent of total capital is in the form of earned surplus.

The increase in total capital is due in large part to the System's strong earnings performance. For the first quarter of 2014, the System reported net income of $1.1 billion. For the 2013 calendar year, the System reported net income of $4.6 billion. With the decline of 18 basis points in the interest rate on earning assets, net interest margin declined in the first quarter to 2.63 percent compared with 2.83 percent the year before. Higher average earning asset balances, up $15.1 billion year over year, helped offset the decline in net interest margin. While the System has been able to take advantage of the low interest rate environment, its ability to continue to lower its cost of debt relative to asset pricing is limited. Some compression of net interest spread is expected as interest rates change and assets prepay or reprice.

Credit quality in the System's loan portfolio continues to be strong. As of March 31, 2014, non-performing loans totaled $2.1 billion, or 1.01 percent of gross loans, as compared with $2.7 billion, or 1.41 percent, for the same quarter a year ago. In comparison to total capital, non-performing loans represented 4.7 percent at quarter-end. High feed costs, which challenged livestock, poultry, and dairy producers through much of 2013, have moderated as a result of the substantial drop in crop prices. Combined with strong product pricing, profit margins for these sectors are substantially higher. Other sectors such as the forestry and nursery industries have also seen a drop in nonaccrual rates as the U.S. housing market continues to strengthen.

The System continues to have reliable access to the debt capital markets. Investor demand for all System debt products has been positive, allowing the System to continue to issue debt on a wide maturity spectrum at very competitive rates. Even as the Federal Reserve started to slowly taper its quantitative easing policy at the end of 2013, risk spreads and pricing on System debt securities remained favorable relative to corresponding U.S. Treasuries. Further strengthening the System's financial condition is the Insurance Fund, which holds more than $3.6 billion. Administered by the Farm Credit System Insurance Corporation, this fund protects investors in System-wide consolidated debt obligations.

System banks also maintain liquidity reserves to ensure they can withstand market disruptions. As of March 31, 2014, the System's liquidity position equaled 183 days, significantly above the 90 day regulatory minimum.

A Changing Risk Profile in Agriculture

The high grain prices of the past few years led to strong earnings for grain and soybean farmers. High grain prices had the inverse effect on the earnings of livestock and dairy producers, constricting their profit margins by driving up their feed costs.

The tables have now turned, however. The large U.S. corn and soybean crops in 2013 and the potentially large crops in 2014 have caused prices for these crops to decline considerably. As a result, the profit margins for livestock and dairy producers have expanded as the profit margins of grain and soybean farmers have constricted. Crop insurance played an important role in supporting grain and soybean farmers' income in 2013, but the level of support it will provide in the future is unclear.

The reduced profit margins in the crop sector are not expected to lead to significant credit problems in the near future because many grain farmers have experienced several years of good earnings and should have the resources necessary to get them through some lean times. Nevertheless, grain farmers who rent most of the land they farm may face greater financial stress than those who have no land rental costs.

Farmland values in the Midwest rose rapidly during the past several years because of high grain prices and historically low interest rates. Most observers agreed that these elevated farmland values were not sustainable because grain prices and

interest rates would likely revert to more sustainable levels, leading to an adjustment in farmland prices. Surveys conducted by several Federal Reserve Banks and Iowa State University indicate that farmland values are adjusting.

Fortunately, farm real estate mortgage underwriting has been conservative among Farm Credit System institutions as well as commercial banks, according to colleagues from other financial regulators with whom we discuss common issues regularly. Consequently, we believe that most FCS institutions will not face significant losses because of adjustments in farmland prices.

FCA staff monitors developments in the farmland market closely, and our examiners have implemented a program for examining the collateral risk management at each Farm Credit institution. In addition, we monitor System real estate mortgage loan-to-value ratios on a quarterly basis. The FCA Board receives semiannual staff reports on the farmland market and loan-to-value ratios at Farm Credit institutions.

Examination Programs for FCS Banks and Associations

FCA is responsible for regulating and supervising the banks, associations, and related entities that compose the Farm Credit System. Our examination and oversight programs provide strategic, proactive risk supervision of the System. In conducting our institution-specific, risk-based oversight and examination activities, we assign highest priority to institutions that present the greatest risk.

We also perform nationally focused examinations that target specific issues and operational areas to monitor the condition and operations of the System as a whole. We actively monitor risks that may affect groups of System institutions or the entire System, including risks from the agricultural, financial, and economic environment.

Through our oversight, we require System institutions to have the programs, policies, procedures, and controls to effectively identify and manage risks. Our oversight program also requires compliance with laws and regulations. When institutions are either unable or unwilling to address unsafe and unsound practices or to comply with laws and regulations, we take appropriate supervisory or enforcement action. We use a comprehensive regulatory and supervisory framework to ensure the System's safety and soundness. FCS institutions, on their own and in response to our efforts, continue to improve their risk management systems.

FCA uses the Financial Institution Rating System (FIRS) to assess the safety and soundness threats to each System institution. Similar to the systems used by other Federal financial regulators, the FIRS is a CAMELS-based system, with component ratings for capital, assets, management, earnings, liquidity, and sensitivity, all factoring into an overall composite rating. System institutions are assigned component and composite ratings based on FCA's evaluation of quantitative and qualitative factors. FIRS ratings range from 1 for a sound institution to 5 for an institution that is likely to fail.

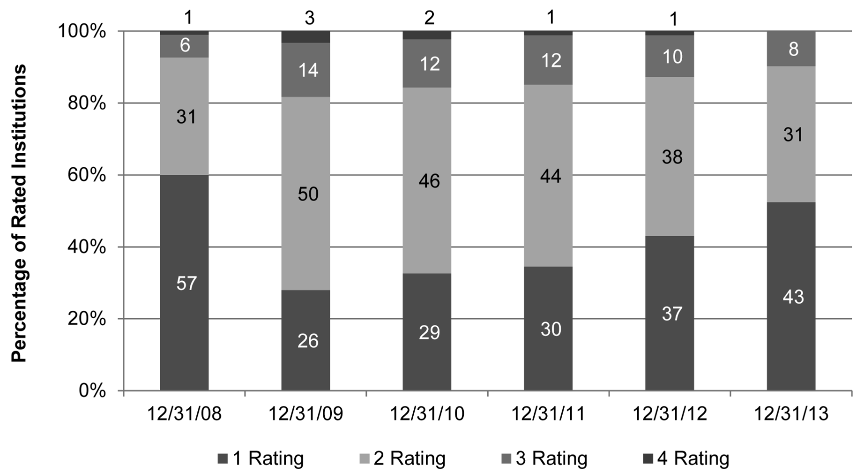
Although the System's financial condition remains sound, a small number of individual institutions display some weaknesses. These weaknesses stem from several factors that have adversely affected some System borrowers:

- The slow pace of economic recovery
- Volatile commodity prices
- Drought in the western United States
- Damaging diseases in the citrus and pork sectors

As the System's regulator, we have increased supervisory oversight and dedicated additional resources to institutions experiencing stress. As of December 31, 2013, eight System institutions had a composite FIRS rating of 3. While these institutions represent about two percent of System assets and do not meaningfully affect the System's consolidated performance, they require significantly more resources to oversee.

The chart below includes the System banks and their affiliated associations. The figures in the bars reflect the number of institutions by FIRS rating.

Farm Credit System FIRS Composite Ratings



Source: FCA's FIRS Ratings Database.

Regulatory Activities

Congress has given the FCA Board statutory authority to establish policy, prescribe regulations, and issue other guidance to ensure that System institutions comply with the law and operate in a safe and sound manner. We are committed to developing balanced, flexible, and legally sound regulations.

Over the past couple of years, we have revised our regulations to accomplish the following objectives:

- To require each System institution's business plan to include strategies and actions to serve all creditworthy and eligible persons in the institution's territory. In addition, the regulation encourages institutions to serve nontraditional customers, such as women and minorities, who often operate within local food systems by producing organic or specialty crops on small farms. The regulation also seeks to achieve diversity and inclusion in the workforce of System institutions.
- To enhance System disclosures of senior officer compensation and supplemental benefit programs.
- To ensure that System institutions maintain effective policies to measure and manage exposure to single counterparties, industries, and market segments, and to large complex loans.
- To ensure that System funding and liquidity requirements are appropriate and to ensure that the discounts applied to investments reflect their marketability.
- To allow System institutions to purchase eligible agricultural loans from the Federal Deposit Insurance Corporation.
- To ensure that prudent practices are in place for the safe and sound management of System investment portfolios.
- To remove all requirements related to nonbinding, advisory votes at System institutions on senior officer compensation.
- To establish a regulatory framework for the reporting of System accounts and exposures to FCA. The revisions reaffirm our authority to collect data on System institution accounts and exposures, including data on shared assets.
- To establish standards for Farmer Mac's capital planning process. The revised process emphasizes the quality and level of capital and annual stress testing.
- To increase the level and quality of assets held in Farmer Mac's liquidity reserve.

Currently, we are working on regulatory projects to accomplish these additional objectives:

- To enhance our risk-based capital adequacy framework to more closely align it with that of other Federal banking agencies and the Basel Accord. We published

a notice of proposed rulemaking to solicit comments on amending our regulations to replace the current core and total surplus capital standards with a "Tier 1/Tier 2" capital framework.

- To implement the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act by imposing margin requirements on noncleared derivatives transactions and removing references to credit ratings.
- To clarify and strengthen the standards-of-conduct requirements for System directors, employees, and agents.
- To seek public input on FCA regulations that may duplicate other requirements, are not effective in achieving the stated objectives, are not based on law, or impose burdens that are greater than the benefits received.
- To clarify and enhance stockholder voting procedures.
- To revise regulatory requirements for mergers or consolidations of banks or associations.
- To strengthen the safety and soundness of the investment activities of System banks by more accurately reflecting the risk in particular investments, and to comply with a provision of the Dodd-Frank Act by replacing credit rating requirements with other standards of creditworthiness.
- To ensure appropriate and effective risk governance and board oversight at Farmer Mac, and to clarify standards-of-conduct and conflict-of-interest requirements.
- To remove reliance on credit ratings from investment eligibility regulations pertaining to Farmer Mac and to maintain the quality and availability of Farmer Mac's liquid investments.

Corporate Activities

The number of FCS institutions has declined over the years as a result of bank and association mergers. Generally, System institution mergers result in larger, more cost-efficient and better-capitalized institutions with broad, diversified asset bases, both by geography and commodity.

However, these mergers also increase the complexity of the continuing institutions. The increased complexity places greater demands on both FCA staff resources, as well as the level of expertise required of staff, particularly in areas of regulation, policy, examination, and legal interpretation. As of January 1, 2014, the System consisted of the following:

- Seventy-eight direct-lender associations
- Three Farm Credit Banks and one Agricultural Credit Bank
- Five service corporations that provide support, technology, leasing, human capital, and other services
- A funding entity that markets the securities—chiefly bonds and discount notes—that the banks sell in the capital markets to raise loan funds
- A GSE with the mission of providing a secondary market for agricultural real estate and rural housing mortgage loans

Federal Agricultural Mortgage Corporation

Congress established Farmer Mac in 1988 to provide a secondary market for agricultural mortgage and rural home loans to improve the availability of cost-effective long-term credit and liquidity to America's farmers, ranchers, and rural communities. Farmer Mac creates and guarantees securities and other secondary market products that are backed by mortgages on farms and rural homes, including certain USDA guaranteed loans. Loan originators that participate in Farmer Mac's secondary market programs include community banks, Farm Credit System institutions, mortgage companies, commercial banks, insurance companies and credit unions. The 2008 Farm Bill expanded Farmer Mac's program authorities by allowing it to purchase and guarantee securities backed by eligible rural utility loans made by cooperative lenders.

Through a separate office required by statute (the Office of Secondary Market Oversight), FCA examines, regulates, and oversees Farmer Mac's operations and its safety and soundness. As the secondary market GSE devoted to agriculture and rural America, Farmer Mac has the statutory authority to, in extraordinary circumstances, issue obligations to the U.S. Treasury Department, not to exceed $1.5 billion, to fulfill the guarantee obligations of its guaranteed securities. The Insurance Fund does not back Farmer Mac's securities, and the System is not liable for any Farmer Mac obligations.

After sustaining losses on liquidity investments during the 2008 financial crisis, Farmer Mac continues to replenish capital and strengthen its operations and risk-bearing capacity to advance its statutory mission. Over the past several quarters, Farmer Mac's capital position has steadily improved, with healthy core earnings growth and recent issuances of high-quality preferred stock. As of March 31, 2014, Farmer Mac's core capital totaled $664.0 million, which exceeded its statutory requirement of $462.5 million. As a result, capital surplus grew to $261.0 million, up from $155.6 million as of March 31, 2013.

New business volume growth is steady. The total portfolio of loans, guarantees, and commitments grew by five percent from March 31, 2013, to $14.1 billion on March 31, 2014. Farmer Mac recently reported that small farm loans contributed 44 percent of the volume related to its new Farm & Ranch program. Despite the decreasing number of small farms, Farmer Mac has seen an overall increase in the dollar volume and number of small farm loans in its programs.

Credit quality indicators reflect the strength in the agricultural and rural utility sectors and Farmer Mac's commitment to strong underwriting standards. As of March 31, 2014, Farmer Mac's 90 day delinquencies were $29.4 million, or 0.56 percent of Farm & Ranch volume, compared with $39.7 million, or 0.83 percent, as of March 31, 2013. Real estate owned as of March 31, 2014, was $2.5 million, down from $4.4 million a year earlier. Farmer Mac reported no delinquencies in its pools of rural utility cooperative loans. On March 31, 2014, Farmer Mac's allowance for losses totaled $14.0 million, compared with $14.3 million on March 31, 2013.

Farmer Mac continues to enjoy reliable access to the debt capital markets to support its mission of providing financing and liquidity to agriculture and rural markets. To improve its financial flexibility in the event of a financial or market disruption, Farmer Mac has taken significant measures to increase the quality and liquidity of its $2.5 billion investment portfolio.

Serving Young, Beginning, and Small Farmers and Ranchers

System institutions are required to develop programs and make special efforts to serve young, beginning, and small (YBS) farmers and ranchers. In 2013, the System continued to show gains in loan dollars outstanding and loan numbers outstanding to YBS producers. In addition, from 2012 to 2013, the number of new loans made to young farmers went up by 2.3 percent, and the number of new loans made to beginning farmers went up by 5.0 percent.

Despite these gains, YBS results as a percentage of the System's total farm loans have either declined or remained flat over the past few years. These results likely reflect the shrinking pool of YBS farmers in the United States. Because of the high costs of starting a farm, fewer people are entering agriculture. Over the years, farms have gotten bigger, and the average age of farmers has gone up.

FCA issued a bookletter in August 2007 to encourage institutions to seek ways to better serve YBS borrowers. The bookletter provides institutions with more flexibility to lend to YBS borrowers and encourages them to use credit enhancements to allow more YBS borrowers to qualify for credit. Credit enhancements for YBS borrowers may include:

- lower rates or fees for YBS borrowers,
- differential underwriting standards, and
- USDA loan guarantees.

In response to this guidance, more institutions are committing capital to assist in their YBS lending, and more are using advisory committees to update YBS policies and procedures. Many institutions have stepped up their YBS outreach efforts and their coordination with outside parties or organizations to serve YBS producers.

In addition to providing credit to YBS borrowers, FCS institutions may offer other financial services to YBS borrowers, and many institutions provide special training and educational programs for them.

Our efforts to encourage System institutions to emphasize diversity and inclusion and to serve producers of local and regional foods also benefit YBS producers. In 2012, to ensure the System fulfills its Congressional mission to serve all eligible, creditworthy borrowers, we issued a regulation requiring institutions to develop human capital and marketing plans that promote diversity and inclusion. Because many small and beginning farmers belong to underrepresented groups, this regulation helps strengthen service to YBS borrowers. Likewise, a bookletter we issued in 2012 to provide guidance regarding service to local and regional foods producers also benefits YBS borrowers because many of these producers would be classified as young, beginning, or small.

Working with Financially Stressed Borrowers

Risk is an inherent part of agriculture, and the causes of risk are many:

- Adverse weather
- Changes in government programs
- International trade issues
- Fluctuations in commodity prices
- Crop and livestock diseases

These risks can sometimes make it difficult for borrowers to repay loans. The Farm Credit Act provides System borrowers certain rights when they apply for loans and when they have trouble repaying loans. For example, the act requires FCS institutions to notify borrowers of the right to seek restructuring of loans before the institutions begin foreclosure. It also provides borrowers an opportunity to seek review of certain credit and restructuring decisions. When a System institution acquires agricultural property through liquidation, the Farm Credit Act also provides borrowers the opportunity to buy or lease back their former properties.

FCA enforces the borrower rights provisions of the Farm Credit Act and examines institutions to make sure that they are complying with these provisions. We also receive and review complaints from borrowers who believe their rights have been denied. Through these efforts, we ensure compliance with the law and help FCS institutions continue to provide sound and constructive credit and related services to eligible farmers and ranchers.

Conclusion

We at FCA remain vigilant in our efforts to ensure that the Farm Credit System and Farmer Mac remain financially sound and focused on serving agriculture and rural America. While we are proud of our record and accomplishments, we remain committed to excellence, effectiveness, and cost efficiency, and we will remain focused on our mission of ensuring a safe, sound, and dependable source of credit for agriculture and rural America. This concludes my statement. On behalf of my colleagues on the FCA Board and at the agency, I thank you for the opportunity to share this information.

The CHAIRMAN. Thank you. I appreciate that. And we will move on to our next witness, Mr. Chris Beyerhelm, Deputy Administrator for Farm Loan Programs, FSA.

STATEMENT OF CHRIS BEYERHELM, DEPUTY ADMINISTRATOR FOR FARM LOAN PROGRAMS, FARM SERVICE AGENCY, U.S. DEPARTMENT OF AGRICULTURE, WASHINGTON, D.C.

Mr. BEYERHELM. Mr. Chairman, Members of the Subcommittee, thank you for this opportunity to appear before you to provide an update on credit conditions in rural America and a status update on how FSA loan programs are working with our commercial lending partners to provide credit to our farmers and ranchers.

The farm economy has been strong in recent years with high farm income and farmland values at or near record levels. However, these highs are not expected to continue, and not all agriculture sectors have benefited from these conditions. An increase in feedgrain production is expected to drive farm income down, and a slowdown in real estate values has already been observed. Our livestock producers and dairy operations are still recovering from extended periods of high feed costs and drought. And input costs for all are expected to remain at near or record high levels of recent years.

Finally, considering all of these events, combined with interest rates creeping up, lenders and their regulators are closely scrutinizing agriculture credit standards, making some producers unable to get credit. For those family farmers who could not qualify for

commercial credit due to lender standards, but otherwise creditworthy, they can turn to the FSA administered guaranteed loan programs. These loan programs are discretionary and are funded through annual appropriations. Federal budget resources have been increasingly leveraged over the last 4 years through loan programs. For example, in 2010, $148 million of budget authority was needed to provide $5 billion of lending authority. While in 2014, a significantly reduced budget authority of $98 million provided for $5.5 billion of lending authority. This is an excellent example of how government programs that are prudently managed the taxpayer with a greater return.

Since early 2009, FSA has experienced record demand levels of loan requests. In each of the last 4 years, FSA has had a significant backlog of approved, but unfunded, loans. To manage this increase, the President's 2015 budget has requested lending authority to go to $6.4 billion. And should these funds be provided, FSA expects for the first time in many, many years to be able to meet all of the demand in our loan programs. This will allow our customers to be better prepared and execute their business plans, and meet on an even playing field for land and preseason discounts.

As of May 2014, the FSA portfolio was $20 billion, 71,000 direct customers, 34,000 guaranteed customers. Performance of the portfolio has been stellar, with loss rates for the direct and guaranteed programs at 1.6 and .3 percent respectively. Delinquencies for direct and guaranteed are 5.4 percent and 1 percent respectively.

The portfolio continues to be fluid with customers moving in and out of the portfolio as it was designed. In fact, of all of the customers in our portfolio in the year 2000, for the operating program, only 14 percent of those remained in 2013. These statistics indicate the program is providing new and beginning farmers an opportunity. But once their financial condition improves, they are able to seek and obtain commercial credit.

The FSA continues to put an emphasis on beginning farmers. The continued increase in average age of farmers and rural population decline says that there is a pressing need that we get new farmers into the industry. We try to take existing loan programs and tweak and revise those to provide benefits to beginning farmers. Most notably, the microloan program you have mentioned earlier has been a tremendous asset to beginning farmers. Since its inception in January of 2013, over 7,200 of these loans have been made. And I am pleased to tell you that over 70 percent of those have been to beginning farmers.

Congress also recognized the importance of beginning farmers in the last farm bill. And soon after enactment, FSA implemented all of the discretionary—or the non-discretionary provisions of the farm bill. And many of those had immediate impact on beginning farmers, though many of the farm bill provisions will be implemented in October of 2014, with the rest in early 2015.

In conclusion, Mr. Chairman, FSA, working together with our commercial lending partners, is delivering a successful lending program with high levels of participation and fiscal responsibility. Our boots on the ground delivery system puts us in a unique position to deliver a quality loan product to the next generations of America's farmers and ranchers. However, we continue to face chal-

lenges: government resources are declining, and agriculture is changing.

We look forward to working with this Committee and others to continue to refine and adjust our programs and processes to maximize the opportunities for our small, beginning and socially disadvantaged farmers, and find the appropriate level of resources in order for us to meet this—or accomplish this mission.

Thank you for allowing me to share the FSA farm loan perspectives as you seek to address this important issue. I look forward to any questions now or in the future. Thank you.

[The prepared statement of Mr. Beyerhelm follows:]

PREPARED STATEMENT OF CHRIS BEYERHELM, DEPUTY ADMINISTRATOR FOR FARM LOAN PROGRAMS, FARM SERVICE AGENCY, U.S. DEPARTMENT OF AGRICULTURE, WASHINGTON, D.C.

Mr. Chairman, and Members of the Subcommittee, thank you for the opportunity to appear before you to provide an update on the credit conditions rural America now faces, and the current status and operations of the farm loan programs at the Farm Service Agency (FSA).

Credit Conditions

The farm economy has been strong the last couple of years with net farm income at an all-time high in 2013, and farmland values currently at, or near, record levels. However, record farm income is not sustainable. A bumper feed grain crop is being forecast for 2014 that could lead to a 27 percent decline in farm income from last year, but farm income is still forecast to be the seventh highest to date. A slowdown in farmland value growth already has been observed. Furthermore, the high commodity prices in prior years did not benefit all producers equally as higher feed costs squeezed livestock and dairy producer margins leaving them with weak balance sheets in need of rebuilding. Compared to 2012, gross crop receipts are forecast to decrease by more than 15.2 percent in 2014, with a $20.2 billion decline in corn receipts and a $6.2 billion decline in soybean receipts expected.

On a historical basis, production expenses are anticipated to fall from 2013 levels, but will remain near their all-time highs, having grown to a forecasted $348.2 billion for 2014, which is a 21.1 percent increase over 2010. Therefore, large amounts of capital will continue to be required to finance agricultural production, increasing the demand for operating credit, financial leverage, and liquidity.

Finally with interest rates bottoming out and farmland values high, credit standards established by lenders and their regulators have been high since 2010 and will likely continue to be high for some time. Recent Federal Reserve Surveys indicate commercial lenders in most regions are maintaining stringent credit standards. This continued high level of loan scrutiny by lenders means some farmers still cannot qualify for commercial credit.

FSA Farm Loan Programs. Family farmers who do not qualify for commercial credit due to lender standards, but are otherwise creditworthy, can turn to the farm loan programs administered by FSA. The Agency assists farmers through direct and guaranteed farm loans. Direct loans are made and serviced by FSA; agency employees provide supervision and technical assistance to direct loan borrowers. Direct loans are not intended to be a permanent source of credit, and borrowers agree to obtain commercial credit and refinance their FSA debts when they are able to do so. In fact, of those borrowers having outstanding operating loans in 2000, only 14 percent remain in the FSA portfolio in 2014.

Guaranteed loans are made, funded and serviced by a commercial lender. FSA typically guarantees up to 90 percent of the loan principal and interest. FSA employees must evaluate and make a credit decision on all guaranteed loans. Guaranteed lenders must retain at least the non-guaranteed portion of the loan in their portfolio and are accountable for loan servicing under the FSA guarantee.

Funding. FSA farm loan programs are discretionary programs funded through annual appropriations. In accordance with the Federal Credit Reform Act of 1990 (as amended), appropriations for FSA farm loans are based on the projected total cost of loans when they are made. Federal budget resources are able to be significantly leveraged through the loan programs. In Fiscal Year (FY) 2014, $97.7 million in appropriations supported $5.53 billion in direct and guaranteed FSA loans which, when provided to American farmers and ranchers, resulted in a significant invest-

ment in the rural parts of our country. Prudent management and program administration, as evidenced by low levels of delinquencies and losses, has allowed FSA to increase leverage of limited budgetary resources over the past several years. For example, in FY 2010, $148.5 million in budget authority was required to support a total program level of $5.08 billion, while in FY 2014, a slightly larger program level requires 34 percent less budget authority.

Loan Demand. Activity in FSA's farm loan programs indicates that a significant number of farmers and ranchers continue to be unable to obtain commercial credit under current conditions. Farm loan program demand is usually a reflection of financial conditions in the farm economy: when the overall farm economy is strong, farm loan activity declines; during times of financial stress in the farm economy, demand for FSA loans rises. This makes sense, given that a basic requirement to qualify for the loan programs is to be unable to meet the criteria for commercial credit.

In early FY 2009, loan demand surged to levels that had not been seen since the early 1980s. Demand for farm loan program assistance in FY 2009, and in 2013, reached its highest levels since FY 1985. Demand has continued at, and in some programs increased above, those near-record FY 2009 levels. In each of the last 4 years FSA has closed out the fiscal year with a significant backlog in approved, but unfunded loans. Application activity in FY 2014 reflects demand levels similar to the higher levels of the previous 5 years. To manage the increased demand, the President's budget request for FY 2015 recommended that loan levels to be increased to $6.4 billion. If these funds are provided, FSA expects, for the first time in many years, to have sufficient funds to meet the demand. This will allow our customers to better prepare and execute their business plans, and compete on an even playing field for land and pre-season discounts on inputs.

Over the past 2 years, an unusually high number of direct operating loan applications have been received from new customers. Normally, about 20 percent of direct operating loan applications in any given year are from farmers who do not have FSA loans. In FY 2013, 37 percent of the direct operating loans made were to customers who did not have existing FSA operating loans.

Performance and Portfolio Conditions

Farm loan programs continue to emphasize the importance of processing applications in a timely manner. Between FY 2008 and FY 2013, the length of time to process direct loans has averaged 28 days. During this period, FY 2010 (the largest loan volume year since the mid-1980s) had the highest average, at just less than 31 days, while the lowest of 25 days was achieved in FY 2013. Similarly, loan processing timeliness in the guaranteed loan program has remained very strong with an average of 9 days over the past 6 years. These results for both the direct and guaranteed programs represent historic lows. This strong performance is continuing in FY 2014. As of May 31, 2014, the average processing time for the direct loan program was 24 days, and 9 days for guaranteed loans. These long-term results are remarkable given that loan demand has surged and staffing levels have declined. The fact that there has not been a noticeable deterioration in application processing time is a testament to the dedication of FSA field staff, implementation of efficiency measures in loan processing, and the effectiveness of the Information Technology (IT) solutions farm loan programs has deployed.

As of May 31, 2014, the FSA direct loan portfolio consisted of $8.2 billion owed by 70,445 borrowers, while the guaranteed portfolio consisted of $11.5 billion owed by 33,847 borrowers. The quality of our portfolio has continued to improve, with foreclosure and loss rates falling while borrower graduation to commercial loans has increased.

Loss Rates. In FY 2013, losses in the direct loan program were just 1.6 percent (see *Chart 1*). Losses for FY 20l3 in the guaranteed loan program were 0.3 percent, (see *Chart 1*).

Delinquency Rates. As with losses, the direct loan delinquency rates have been at historic lows for the past 2 decades at 5.4 percent for FY 2013 (see *Chart 2*). This is the result of steady and dramatic decreases, from a 23.8 percent delinquency rate in FY 1995. The decrease was facilitated by expanded authority, since 1996, to offset delinquent borrowers' loan obligations with their Federal payments, salaries and income tax refunds. In the guaranteed program, the FY 2013 delinquency rate was 1.07 percent; the lowest on record (see *Chart 2*).

Graduation rates: FSA does not provide permanent financing; direct loan borrowers are required to move to commercial credit or graduate when they are able to do so. Statistics indicate that the vast majority of borrowers leave the FSA portfolio in a relatively short (given a potential 40+ year farming career) period of time. Eighty six percent of the operating loan borrowers in the FSA portfolio in 2000 no

longer owed an operating loan by 2013. In the farm ownership program, over 70 percent of the borrowers in the FSA portfolio in 2000 had left by 2013. These statistics indicate the program is providing new and beginning farmers an opportunity to obtain credit, but after establishing themselves financially, are able to seek and obtain commercial credit.

Equitable Treatment and Participation

I, along with all members of the FSA management team, remain fully committed to providing equal access and opportunity to all those FSA serves. In FY 2013, while FSA received more than 50,000 loan applications, more than 2,700 loan servicing requests, and tens of thousands of applications for various farm commodity, income support, and disaster assistance programs, the Assistant Secretary for Civil Rights received only 19 civil rights complaints related to FSA programs. While this is the lowest number of FSA civil rights complaints received since records have been kept, it is our goal to further reduce this number.

I will closely monitor the operations of farm loan programs to assure that our producers, program applicants, and employees receive fair and equitable treatment. I want to update you on a few key activities dealing with these important issues.

Program participation. An examination of the composition of FSA's loan portfolio indicates that FSA finances socially disadvantaged farmers at a much higher rate than that groups' proportion of the farm population. FSA has significantly increased the amount of loan funds provided to socially disadvantaged applicants. Between 2008 and 2013, the FSA direct loan caseload for socially disadvantaged borrowers increased from 14,068 to 15,514.

New and Beginning Farmers. The continuing increase in the average age of farmers and decline in rural population both point to a pressing need for more beginning farmers. As a result, assisting and fostering beginning farmers and ranchers remain a primary concern and focus for FSA farm loan programs. While the general strength of the agriculture economy is certainly a positive factor for rural America, the resulting increases in land values and other capital costs have made it ever more difficult for beginning farmers to get started and become established. More than ever, beginning farmers need a hand up to start their journey toward success.

FSA is committed to effective use of farm loan programs and authorities to assist beginning farmers. Beyond implementation of the 2014 Farm Bill provisions benefitting beginning farmers, FSA has implemented or modified programs under existing authorities to better fit the needs of beginning farmers. Most notably, the microloan program, a subset of the direct operating loan program, has been tremendously successful in assisting beginning farmers. This program, launched in January 2013, reduces paperwork by half and is designed to fit the business plans of non-commodity operations such as local food, community-supported agriculture, urban agriculture and niche market farm businesses which are attracting many beginning farmers. So far this year, 72 percent of the microloans made have gone to beginning farmers. Although the program is still new, performance, so far, is very good, with over 7,200 loans made.

In addition to the microloan program, FSA implemented a "streamlined loan" application process for repeat operating loan customers with good repayment history on FSA loans. This allows FSA to provide more timely service to many beginning farmer borrowers and frees staff time so they may spend more time with those borrowers who need additional help or technical assistance.

2014 Farm Bill Implementation. Congress also recognized the criticality of the situation for beginning farmers and re-affirmed the focus on them for FSA programs in the 2014 Farm Bill. FSA continues to strive to reach more beginning farmers and ranchers and has increased the amount of loan funds provided to beginning farmers and ranchers. The FSA direct loan caseload for beginning farmers increased from 18,785 in 2008 to 31,659 borrowers in 2013.

FSA was able to implement several nondiscretionary provisions of the farm bill shortly after enactment, including provisions to increase the guarantee percentage on guaranteed conservation loans, reduce the interest rate on joint financing loans, increase the loan limit on down payment loans, eliminate guaranteed loan term limits, change the land ownership limitation for beginning farmer applicants, eliminate the restriction on youth loans to rural areas, and reduce credit limitations for delinquent and defaulted youth loan borrowers. Several of these had an immediate impact on beginning farmers. In particular, the change in interest rates on joint financing farm ownership loans benefitted hundreds of applicants with applications pending, but not yet funded, at the time of implementation.

Several additional farm bill provisions will be implemented through an interim rule scheduled for publication in October 2014, including changes to eligibility rules for entities, experience requirements for direct ownership loans, and increasing the

microloan limit to $50,000. These provisions will add flexibility or enhance programs for beginning farmers as well. The Agency plans to publish a request for suggestions for pilot projects authorized in Section. 5302, and hopes to receive suggestions for projects that demonstrate new approaches to assist beginning farmers and others through farm loan programs. In addition, we are prepared to implement the Individual Development Accounts authorized by the farm bill if funding is provided.

IT Modernization. Farm loan programs has also implemented modern, web-based systems to manage the loan application, approval and funding process. This system provides real-time management data on application activity and allows the Agency to better cope with funding problems and act quickly when necessary. For example, when the Agency received supplemental funding in the American Revitalization and Recovery Act, over 2,000 farmers were waiting for desperately needed direct operating loans to pay 2009 planting and other farming expenses. When funds were made available to FSA, the Agency was able to process obligations overnight, and funds began flowing into farmers' bank accounts only 3 days later. I am proud to say that FSA was one of the first agencies in the government to get recovery dollars flowing to those who urgently needed it. The modern, web-based IT systems in place for farm loan programs, such as the Direct Loan System and the Program Funds Control System, were, and are, a key factor in our ability to provide such timely service.

The continued efforts to move all automated systems to the Web will allow for the elimination of duplicate data collection and for farm loan services to be delivered even more efficiently. This will further our mission to conduct USDA business from any location where there is broadband or WiFi Internet access and allow us to conduct business with producers at locations and times convenient to them. Additionally, loan information is stored on a centralized server allowing employees to quickly access portfolio information and provide real time management reports.

Conclusion

Through modernization efforts, maintaining focus on program objectives, and the hard work and dedication of FSA employees, FSA farm loan program staff has made great strides in improving program performance. Loan failures and losses have declined which is a strong indication that the program mission of helping farmers become successful is being accomplished. At the same time, increased assistance to small, beginning, and socially disadvantaged farmers, reflects remarkable success as well.

However, we continue to face challenges. Government resources are increasingly limited and the agriculture production landscape is changing. It will require every bit of innovation, management expertise, and determination that we can muster to maintain the efficiency and efficacy of farm loan programs over the next several years.

We are experiencing a unique set of conditions in the credit and banking sectors, and to a large extent, in agriculture. These changes pose significant barriers and challenges to the groups that FSA farm loan programs are intended to assist. These issues create major challenges for the agency as well, since the success of the program depends on those whom the programs are intended to serve. To keep pace with these changes, we look forward to working with you to continue efforts to modernize our delivery systems, and to refine and adjust program requirements and operations to maximize the opportunities for our nation's small, beginning, and socially disadvantaged farmers and ranchers and to seek a level of resources appropriate for this important mission.

Because of our rural delivery system and experienced loan officers, FSA's farm loan programs staff is well positioned to continue providing high quality delivery of existing programs and new initiatives to assist small, beginning, and socially disadvantaged family farmers.

Thank you for allowing me to share our Department of Agriculture perspective as you seek to address this important issue. I am available to answer your questions now or at any time in the future.

CHARTS

Chart 1

Farm Loan Programs Loss Rates

10 Year Trend

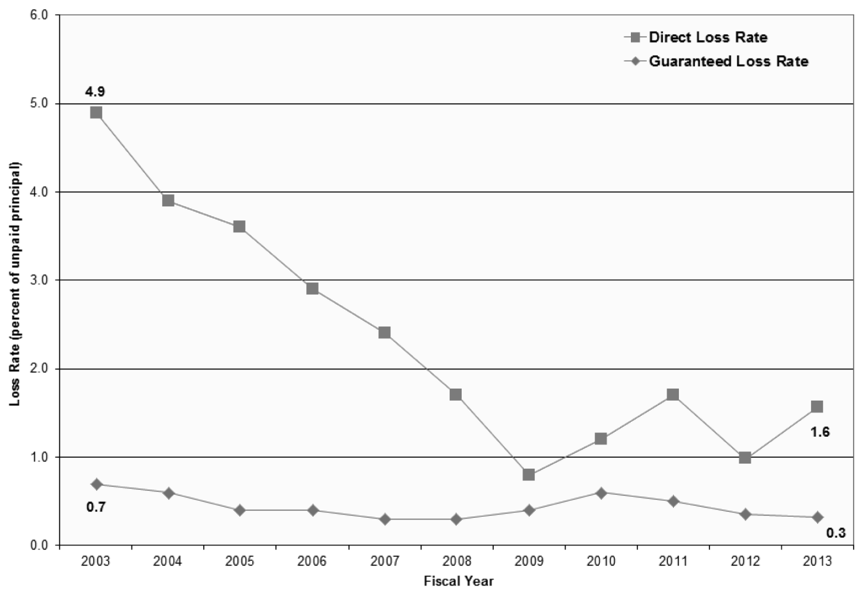
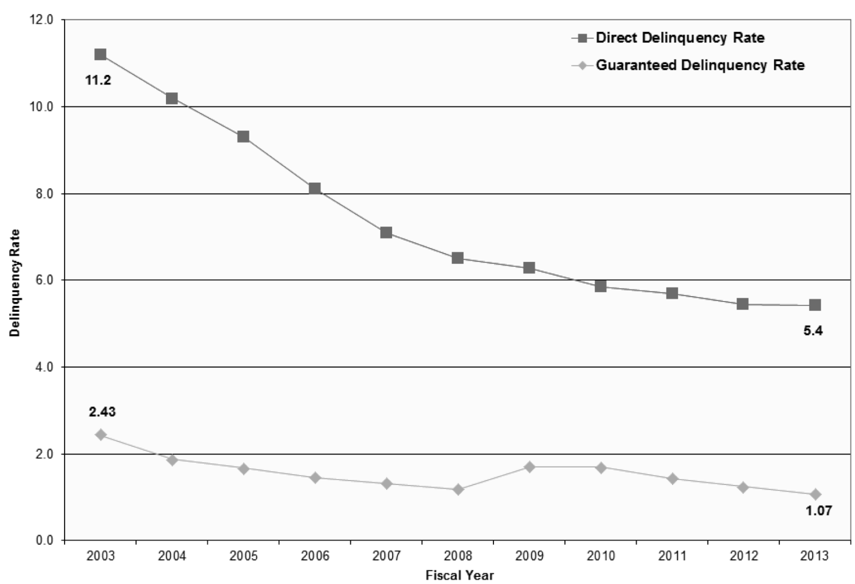


Chart 2

Farm Loan Programs Dollar Delinquency Rates

10 Year Trend



The CHAIRMAN. Thank you, sir. Now, I am pleased to recognize the Vice President, Federal Reserve Bank of Kansas City, Mr. Nathan Kauffman. You are recognized for 5 minutes.

STATEMENT OF NATHAN S. KAUFFMAN, ASSISTANT VICE PRESIDENT, FEDERAL RESERVE BANK OF KANSAS CITY, OMAHA BRANCH, OMAHA, NE

Mr. KAUFFMAN. Thank you, Mr. Chairman, and Members of the Subcommittee. Thanks for the opportunity to speak to you this morning. My name is Nathan Kauffman, and I am Assistant Vice President and Economist at the Federal Reserve Bank of Kansas City, our regional reserve bank that has long devoted significant attention to U.S. agriculture. In my role, I lead several efforts to track the agricultural and rural economy, including a regional agricultural credit survey and the Federal Reserve System's *Agricultural Finance Databook,* which is a national survey of agricultural lending activity at commercial banks.

I am pleased to share with you this morning information on the current state of agricultural credit markets. Before I begin, let me emphasize that my statement represents my view only, and is not necessarily that of the Federal Reserve System or any of its representatives.

The U.S. agricultural economy has been very strong since 2009. According to the USDA, average farm income from 2010 through 2013 annually was about 46 percent higher than the average of the previous 10 years. Crop prices surged and cropland values increased dramatically during that time. In key crop producing states, cropland values rose by more than 20 percent annually for several consecutive years, which strengthened overall farm sector balance sheets. The crop sector was a primary driver of these near record farm incomes, while the livestock sector experienced multiple years of poor profits or losses due to elevated feed costs.

Several key measures of agriculture credit conditions monitored by the Kansas City Fed also improved from 2009 to 2013. According to Federal Reserve surveys of agricultural banks, repayment rates for agricultural production loans in the Kansas City, Chicago and Minneapolis districts all improved considerably alongside rising farm income. Profitability and agricultural banks also strengthened significantly.

During this time, however, bankers commented that agricultural loan demand had fallen despite declining interest rates, as farmers used more cash to pay for farm related expenses. Although the overall financial position of the farm sector had improved, some agricultural producers were more at risk for financial stress than others. Our banker contacts consistently voiced concerns about the viability of some livestock operations facing steep losses, as well as young and beginning farmers with significantly less equity in their operations.

Since last fall's crop harvest, sharp changes in agriculture commodity prices have led to corresponding changes in the outlook for the farm sector and agricultural finance. Current corn prices are about 40 percent less than last year. Conversely, average fed cattle prices are approximately 25 percent higher than a year ago. And

overall livestock prices and lower feed costs have contributed to a rebound in livestock sector profitability.

Lower crop prices and persistently high input costs have reduced profit margins for U.S. crop producers and have affected recent trends in agricultural lending. Toward the end of 2013, declining profit margins reduced farm cash flow. As a result, demand for some agricultural loans began to rise, and lending activity jumped considerably in the first quarter of 2014. The Federal Reserve's *Agricultural Finance Databook,* included with my written testimony, shows that the volume of new short-term farm loan originations increased by 28 percent from the previous year in the first quarter. Total farm debt at commercial banks increased by 9.1 percent from the year earlier. And non-real estate farm debt rose by 9.9 percent, which was the biggest year over year increase since 2001. Delinquency rates on agricultural loans, however, have remained historically low. And bankers have continued to report that ample funds are available for agricultural borrowers, amid a relatively competitive environment for high quality agricultural loans.

Looking ahead, the level of working capital and overall liquidity in the farm sector will be crucial components of the financial health and credit conditions surrounding U.S. farm operations. If profit margins remain under pressure in the crop sector, and debt continues to rise, the ability of crop producers to withstand an increase in financial stress may be a concern, even as the outlook for the livestock sector has improved. Farmers with lower levels of equity, including young and beginning farmers, may be most vulnerable to financial stress, particularly if cropland values fall and farm income declines from its historically high levels.

Despite these concerns, commercial banks have continued to recognize the long-term potential for U.S. agriculture and have financed the sector accordingly, albeit more cautiously in some areas.

Thank you, Mr. Chairman, for inviting me today. This concludes my remarks. I would be happy to answer any questions there may be.

[The prepared statement of Mr. Kauffman follows:]

PREPARED STATEMENT OF NATHAN S. KAUFFMAN, ASSISTANT VICE PRESIDENT, FEDERAL RESERVE BANK OF KANSAS CITY, OMAHA BRANCH, OMAHA, NE

Thank you Mr. Chairman and Members, of the Subcommittee. My name is Nathan Kauffman, and I am Assistant Vice President and Economist at the Federal Reserve Bank of Kansas City, a regional Reserve Bank that has long devoted significant attention to U.S. agriculture. In my role, I lead several efforts to track the agricultural and rural economy, including a regional agricultural credit survey and the Federal Reserve System's *Agricultural Finance Databook,* a national survey of agricultural lending activity at commercial banks. I am pleased to share with you the following information on the current state of agricultural credit markets. Before I begin, let me emphasize that my statement represents my view only and is not necessarily that of the Federal Reserve System or any of its representatives.

Agricultural Finance and Credit Conditions: 2010 to 2013

The U.S. agricultural economy has been very strong since 2009. According to the U.S. Department of Agriculture (USDA), average real net farm income from 2010 through 2013, annually, was about 46 percent higher than the average of the previous 10 years. Crop prices surged and cropland values increased dramatically during that time, rising by more than 20 percent annually in key crop-producing states for several consecutive years, which strengthened overall farm sector balance sheets. The crop sector was a primary driver of these near-record farm incomes, while the

livestock sector experienced multiple years of poor profits or losses due to elevated feed costs.

Several key measures of agricultural credit conditions monitored by the Kansas City Fed also evolved positively from 2009 to 2013. According to Federal Reserve surveys of agricultural banks, repayment rates for agricultural production loans in the Kansas City, Chicago and Minneapolis districts all improved considerably alongside rising farm income, and profitability at agricultural banks strengthened significantly. During this time, however, bankers commented that agricultural loan demand had fallen, despite declining interest rates, as farmers used more cash to pay for farm-related expenses.

Although the overall financial position of the farm sector had improved, some agricultural producers were more at risk for financial stress than others. Our banker contacts consistently voiced concerns about the viability of some livestock operations facing steep losses, as well as young and beginning farmers with significantly less equity in their operations.

Current Agricultural Finance and Credit Conditions

Since last fall's crop harvest, sharp changes in agricultural commodity prices have led to corresponding changes in the outlook for the farm sector and agricultural finance. Current corn prices are about 40 percent less than last year. Conversely, average fed cattle prices are approximately 25 percent higher than a year ago and, overall, higher livestock prices and lower feed costs have contributed to a rebound in livestock sector profitability.

Lower crop prices and persistently high input costs have reduced profit margins for U.S. crop producers and have affected recent trends in agricultural lending. Toward the end of 2013, declining profit margins reduced farm cash flow, and as a result, demand for operating and other agricultural loans began to rise and lending activity jumped considerably in the first quarter of 2014. The Federal Reserve's *Agricultural Finance Databook,* included with my written testimony, shows that the volume of new, short-term farm loan originations increased by 28 percent from the previous year in the first quarter. Total farm debt at commercial banks increased by 9.1 percent from a year earlier, and non-real estate farm debt rose by 9.9 percent, the biggest year-over-year increase since 2001. Delinquency rates on agricultural loans, however, have remained historically low and bankers have continued to report that ample funds are available for agricultural borrowers amid a relatively competitive environment for high-quality agricultural loans.

Looking ahead, the level of working capital and liquidity in the farm sector will be crucial components of the financial health and credit conditions surrounding U.S. farm operations. If profit margins remain under pressure in the crop sector and debt continues to rise, the ability of crop producers to withstand an increase in financial stress may be a concern, even as the outlook for the livestock sector has improved. Farmers with lower levels of equity, including young and beginning farmers, may be most vulnerable to financial stress, particularly if cropland values fall and farm income declines from its historically high levels, as projected by USDA and Federal Reserve surveys. Despite these concerns, commercial banks have continued to recognize the long-term potential for U.S. agriculture and have financed the sector accordingly, albeit more cautiously in some areas.

This concludes my formal remarks and I would be happy to answer any questions you may have. Thank you.

ATTACHMENT

Agricultural Finance Databook

Operating Loans Drive Recent Increases in Farm Lending

By Nathan Kauffman and Maria Akers

April 2014

Farm loan volumes at commercial banks rose dramatically in the first quarter of 2014, driven by increased demand for short-term production loans. According to a national survey of commercial banks from the first full week of February, agricultural producers borrowed larger amounts compared with last year to cover current operating expenses. Lower crop prices reduced cash flow for farmers selling the remainder of last year's crop and overall crop input costs remained high despite a moderate decline in fertilizer prices. Feeder livestock loan volumes also rose as low inventories pushed feeder cattle and hog prices higher. In contrast, farm capital spending slowed further, lessening the need for intermediate-term farm machinery and equipment financing.

Small and midsize banks added loans faster than their larger competitors under differing terms. Non-real estate farm loan volumes increased nearly 30 percent from last year at small and midsize banks compared with a 20 percent rise at large banks. Commercial banks competed for larger average loan amounts by extending loan maturities and lowering interest rates. The majority of loans at large banks featured a floating interest rate, while customers of small and midsize banks locked in more fixed-rate loans compared with last year.

Loan quality at agricultural banks improved during 2013 and contributed to solid profits. Following steady improvement the past 3 years, the return on assets at agricultural banks in the fourth quarter held at a high level and annual net income distributions strengthened. Despite a drop in crop prices at harvest, producers still paid down debt, reducing delinquency rates and net charge-offs for both farm real estate and non-real estate loans.

After several years of exceptionally strong price appreciation, farmland values rose at a much slower pace in the fourth quarter. With lower crop prices expected to persist in 2014, most bankers expected farmland values would stabilize while some expected modest declines.

Section A

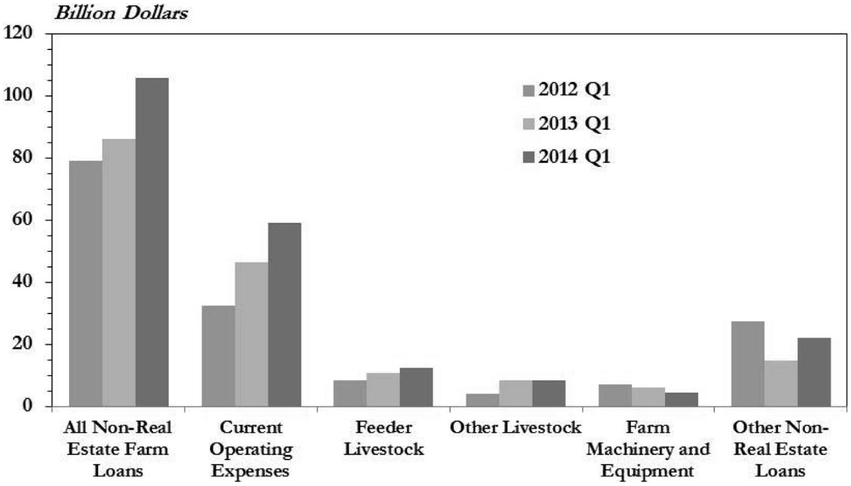
First Quarter National Farm Loan Data

Farm borrowing ramped up in the first quarter as farmers prepared for spring planting. Operating loan volumes reached a record high, exceeding year-ago levels by 28 percent (*Chart 1*). Crop prices at the beginning of 2014 had fallen 40 percent from the previous year, lowering cash receipts for producers still marketing fall crops. In addition, while prices fell for some crop inputs, such as fertilizer, others, such as seed and fuel, were expected to hold at high levels (*Chart 2*). Reduced cash flow coupled with elevated crop production costs contributed to the upswing in operating loan volumes. The volume of feeder livestock loans also rose as low cow inventories kept feeder cattle prices elevated and hog prices jumped as an ongoing swine virus continued to limit hog supplies.

Larger operating loans contributed to loan portfolio growth, particularly at small and midsize banks. In the first quarter, non-real estate lending at small and midsize banks rose 28 percent, exceeding the 20 percent rise at large banks (*Chart 3*). In a competitive lending environment, average effective interest rates continued to edge down and average loan maturities lengthened regardless of bank size. However, at large banks twice as many loans were made with floating interest rates compared with small and midsize banks where fixed-interest rate loans were more prevalent.

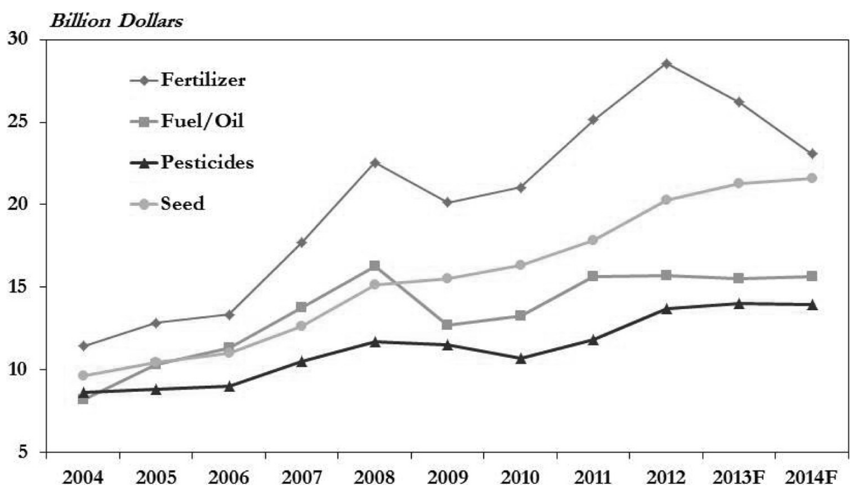
Despite an overall increase in loan volumes, the volume of farm machinery and equipment loans fell by almost a third compared with the previous year, marking the fifth straight quarter of decline. Capital spending may have declined because operators recently upgraded equipment in high income years when tax depreciation rules were more favorable. Additionally, the prospect of lower farm income in 2014 may have shifted financing from intermediate-term equipment loans to short-term operating needs.

Chart 1: Non-Real Estate Farm Loan Volumes by Purpose



Source: *Agricultural Finance Databook,* Table A.3.

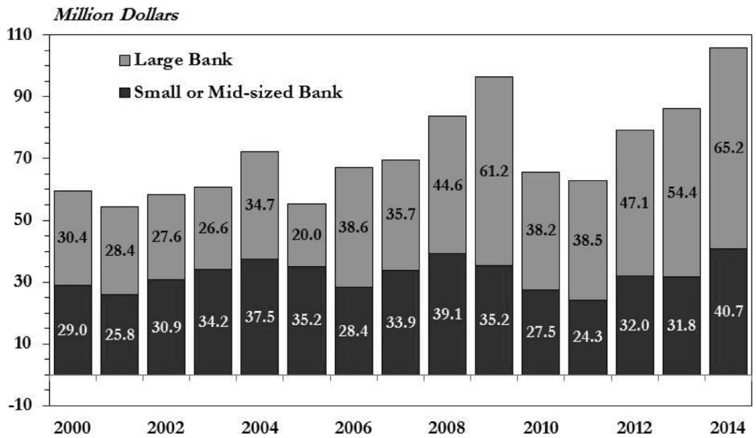
Chart 2: Principal Crop Input Costs



Source: USDA Economic Research Service, Farm Income and Wealth Statistics.

Note: Data for 2013 and 2014 are forecasts.

Chart 3: Non-Real Estate Loan Volumes by Bank Size (First Quarter)



Source: *Agricultural Finance Databook,* Table A.3.

Section B

Fourth Quarter Call Report Data

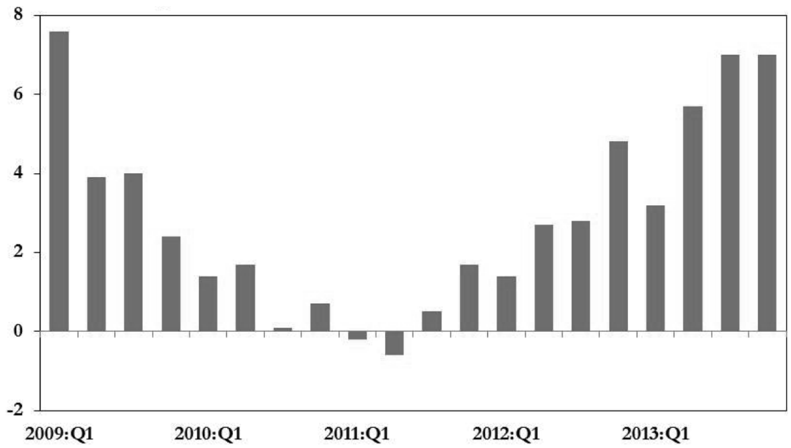
Commercial bank call report data showed that agricultural loan volumes in the fourth quarter exceeded year-ago levels. Total farm debt outstanding as of December 31, 2013, rose seven percent year-over-year, outpacing the five percent gain at the end of 2012 (*Chart 4*). The volume of loans secured by farmland rose 7.3 percent, followed closely by a 6.6 percent increase in production loans. A drop in crop prices at harvest tightened margins and may have contributed to the rise in production loan volumes at year-end.

Commercial banks reported improved loan performance in the fourth quarter. Delinquency rates on farm real estate loans continued to trend down at both large and small banks. In addition, delinquency rates on non-real estate farm loans dipped below two percent at the 100 largest commercial banks for the first time since 2008 (*Chart 5*). Furthermore, the percentage of farm loans 30 to 90 days past due was smaller than last year, suggesting delinquency rates could fall further. The volume of loans charged off against reserves at agricultural banks fell by almost half compared with the fourth quarter of 2012.

Profitability at agricultural banks remained strong at the close of the year. The return on assets at agricultural banks stabilized at the 10 year average and exceeded returns at other small banks by more than ⅓ (*Chart 6*). Net income distributions as a share of average equity improved and there were no agricultural bank failures in 2013. With more lending activity, average capital ratios dipped slightly at both agricultural and other small banks in the fourth quarter and average loan-to-deposit ratios were higher than a year ago.

Chart 4: Farm Debt Outstanding at Commercial Banks

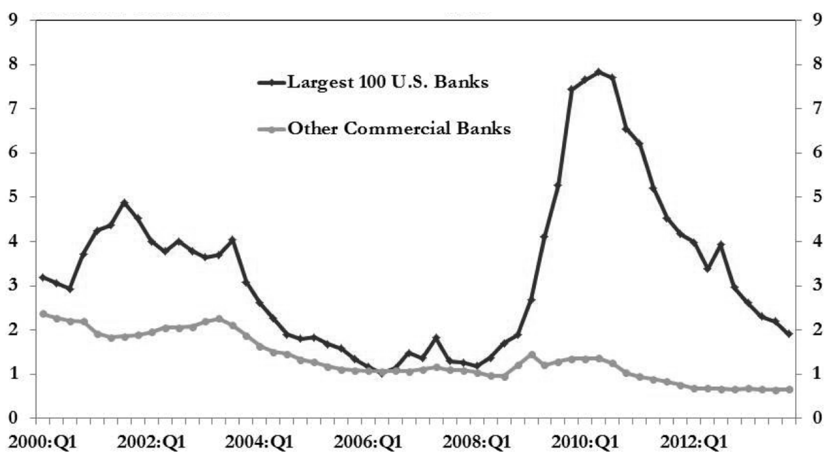
Percent Change From Previous Year



Source: *Agricultural Finance Databook,* Table B.1.

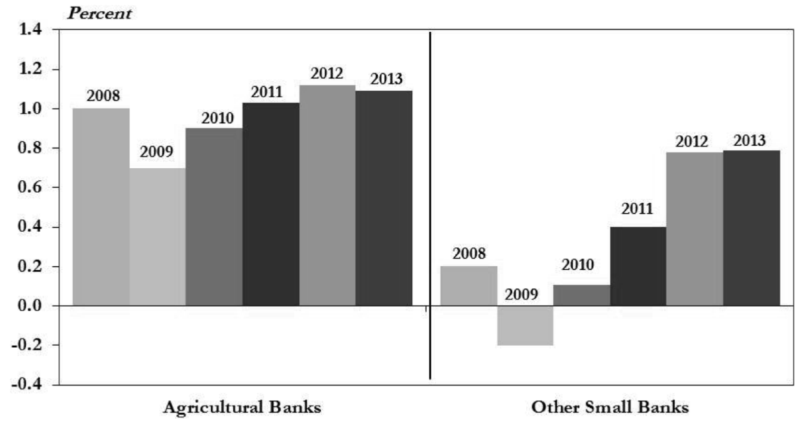
Chart 5: Delinquency Rates on Non-Real Estate Farm Loans

Percent of Outstanding Loans, Seasonally Adjusted



Source: Federal Reserve Board of Governors.

Chart 6: Rate of Return on Assets (Fourth Quarter)



Source: *Agricultural Finance Databook,* Table B.7.

Section C

Fourth Quarter Regional Agricultural Data

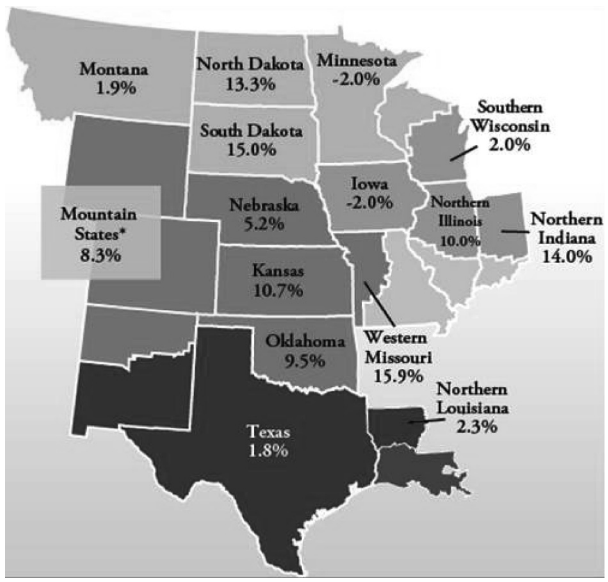
Demand for farm operating loans rose sharply in many major grain producing areas in the fourth quarter while farm capital spending waned. The steep drop in crop prices at harvest lowered earlier expectations for 2013 farm income, particularly in the Kansas City Federal Reserve District where drought affected crop yields. Low crop prices also prompted some producers to store grain inventories rather than sell in case prices rebounded later. Reduced cash flow increased demand for operating loans, particularly across the Corn Belt and northern Plains in the Chicago, Kansas City and Minneapolis Districts. Crop receipts were also down in the Dallas District, but bankers indicated strong cattle prices and revenue from oil and gas leases supported overall farm income levels. Conversely, bankers in the St. Louis District reported farm income strengthened compared with the previous year and loan demand weakened. In a reversal of recent trends in which farm capital spending spiked at year-end, contacts in the Chicago, Kansas City, Minneapolis and St. Louis Districts noted a drop in capital investment in the fourth quarter of 2013.

Farm income levels influenced farm credit conditions in the fourth quarter. Loan repayment rates in the Chicago, Kansas City and Minneapolis Districts eased from strong positions earlier in the year. Bankers in these Districts also reported a modest rise in the number of loan renewals and extensions in the fourth quarter and slightly tighter collateral requirements. However, the Dallas and St. Louis Districts reported stronger loan repayment rates and fewer loan renewals and extensions. Despite minor deterioration in credit conditions in some areas, interest rates on farm operating loans were steady to lower in all Districts except Kansas City where they edged higher. Interest rates on farm real estate loans fell further in the Dallas, Minneapolis, Richmond and St. Louis Districts, held steady in the Kansas City District and rose slightly in the Chicago District.

Agricultural bankers indicated farmland value gains slowed dramatically in the fourth quarter despite less farmland for sale compared with last year. In particular, bankers in Corn Belt states reported year-over-year increases in nonirrigated cropland values moderated from previous highs (*Map*). There was even a slight pullback in cropland values in parts of Minnesota and Iowa. Energy activity continued to support farmland value gains in the Dakotas, but a majority of bankers felt that lower farm income expectations for 2014 would limit further farmland value gains in major crop producing areas.

Map: Value of Non-Irrigated Cropland (Fourth Quarter, 2013)

Percent Change From Previous Year



* Mountain states include: Wyoming, Colorado, and northern New Mexico, which are grouped because of limited survey responses from each state.

Sources: Federal Reserve District Agricultural Credit Surveys (Chicago, Minneapolis, Kansas City, and Dallas).

Addendum

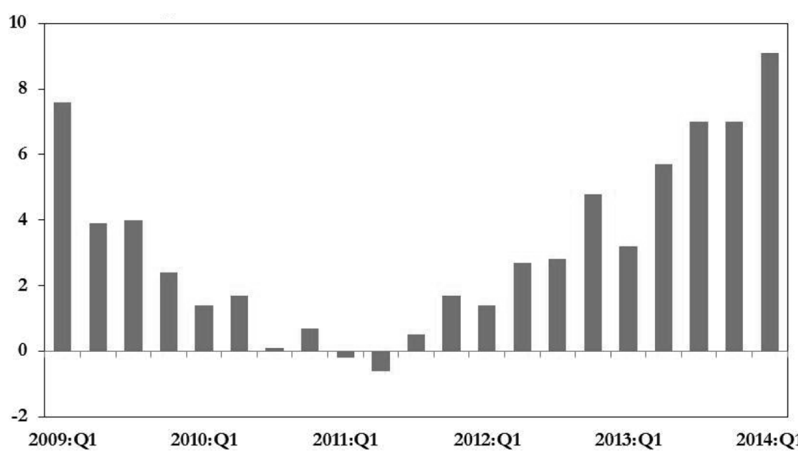
Agricultural Finance Databook

Previous Charts Updated Through First Quarter 2014

Section B

Chart 4: Farm Debt Outstanding at Commercial Banks

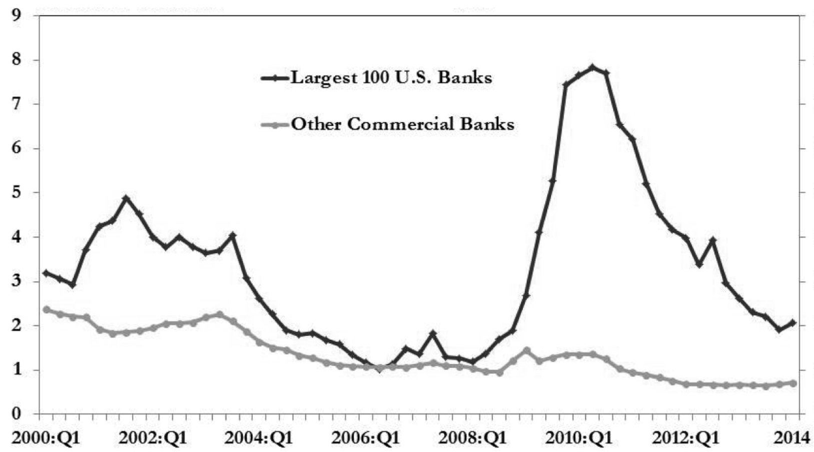
Percent Change From Previous Year



Source: *Agricultural Finance Databook,* Table B.1.

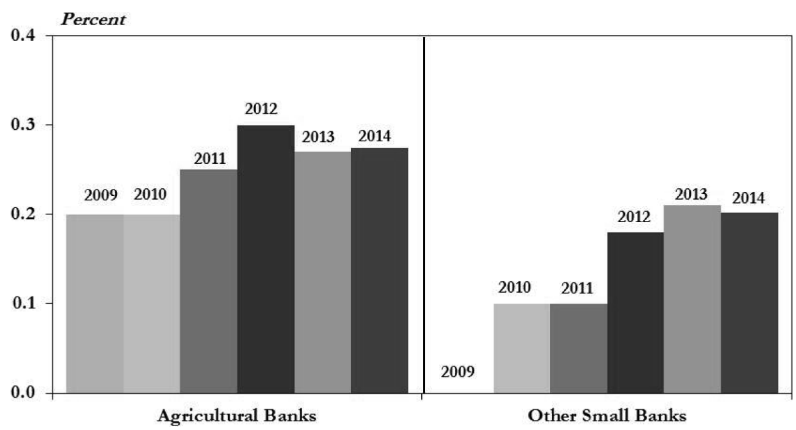
Chart 5: Delinquency Rates on Non-Real Estate Farm Loans

Percent of Outstanding Loans, Seasonally Adjusted



Source: Federal Reserve Board of Governors.

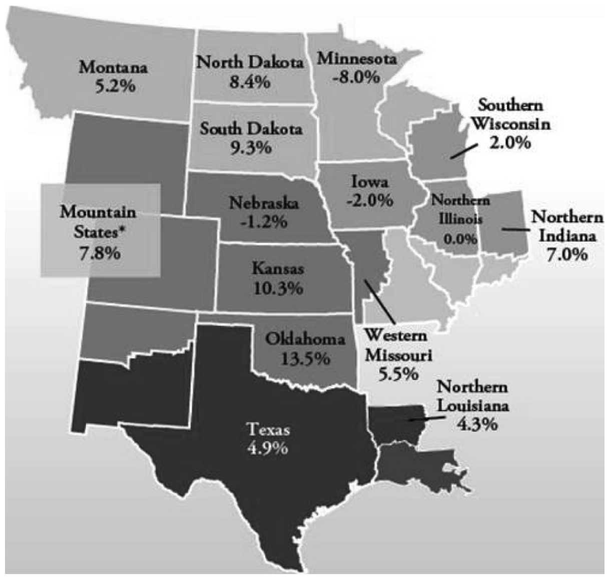
Chart 6: Rate of Return on Assets (First Quarter)



Source: *Agricultural Finance Databook,* Table B.7.

Map: Value of Non-Irrigated Cropland (First Quarter, 2014)

Percent Change From Previous Year



*Mountain states include: Wyoming, Colorado, and northern New Mexico, which are grouped because of limited survey responses from each state.

Sources: Federal Reserve District Agricultural Credit Surveys (Chicago, Minneapolis, Kansas City, and Dallas).

The CHAIRMAN. Thank you. And I want to thank all the panelists for being so accurate on your time. It was wonderful. It doesn't happen all the time. Again, I thank you. And I thank the witnesses.

The chair would remind the Members that they will be recognized for questioning in order of seniority for Members who were present at the start of the hearing. After that, Members will be recognized in order of their arrival. I appreciate your understanding.

I will recognize myself to begin the questioning. I recognize myself for 5 minutes. I want to start with Dr. Long Thompson.

You testified that non-performing loans totaled $2.1 billion, which is a decrease of nearly $600 million. Is the non-performing loan portfolio—is that a geographic prerogative? Is it dominated by any certain sector of the ag industry, or is there a region in the country that may contribute more so than others?

Dr. LONG THOMPSON. Well, certainly, among those institutions that we regulate, if they happen to be located in a part of the country where there has been stress, you might see some additional—a higher level of non-performing loans. But we haven't detected a specific pattern geographically. I would, however, be very happy to provide you—we have very good data. We do analyses of the overall farm economy, as well as of the health of the System regularly. And we have some very good data that I would be happy to share with you and your staff.

[The information referred to is located on p. 91.]

Dr. LONG THOMPSON. The non-performing loans tend to occur in those areas of agriculture that are under stress. And if there happens to be a small association that has a high percentage of loans in that area, you might find that within one association or another association. But, generally speaking, across the board, the System is safe and sound.

The CHAIRMAN. Okay. Excellent. You also mentioned the Farm Credit Insurance Fund. Do any other GSAs have any similar type of insurance fund or reserves that you are aware of?

Dr. LONG THOMPSON. Well, someone else could probably better answer that question. I think you know very well the history of the Farm Credit System Insurance Corporation, which was established in the late 1980s after the crisis in the farm economy. And that fund, of course, exists to insure the banks should there be a situation where they were not able to repay their loans. So I can't really speak to other agencies and what they do. Of course, the FDIC has an insurance fund that is not unlike what the Farm Credit System insurance fund is.

The CHAIRMAN. Okay. I want to move on to something that will more than likely come up in the next panel. I think you are obviously someone who should be given an opportunity to comment on it. And it relates to CoBank's role in two transactions. One was the finance package with Verizon, the other being a financing package with Frontier Communications. I would like to get your perspective on that. First, does CoBank have the authority to participate in those transactions? And, second, did FCA have any role in approving those transactions?

Dr. LONG THOMPSON. The answer to your first question is yes, they did have the authority. As you know, Congress gave the enti-

ties that we regulate the authority to engage in similar-entity participation lending to be used as a risk mitigation tool. And we reviewed those transactions in complete detail and found that they met any reasonable reading of the statutory authority provided.

Now, in the interest of full disclosure, I have to tell you that I was on the ag committee and the subcommittee that had jurisdiction over credit issues at the time that the language was adopted. And I recall supporting it. However, I also have to say that it is not a model of drafting clarity. And I am not sure anywhere else in Federal statute you would even find the terms *functional similarity*. Even so, there are statutory limits. And those statutory limits include, for example, a single credit held by a System institution may not exceed ten percent of total capital; a single System institution, and all System institutions combined, must hold less than 50 percent of the credit; a System institution may not exceed 15 percent of its total assets in similar-entity participations. And at the present time, System-wide, somewhere around five percent of the System's total assets are held in some form of similar-entity participation. But we do examine—we do ensure that they are in compliance. And they are.

The CHAIRMAN. Thank you. I yield the balance of my time. I now recognize the Ranking Member for 5 minutes.

Mr. COSTA. Thank you very much, Mr. Chairman.

Mr. Beyerhelm, you mentioned increased demand for loans with FSA. And, as you know, we are the authorizers. But did the appropriators provide sufficient funding to meet what you believe is going to be the demand in Fiscal Year 2015?

Mr. BEYERHELM. From what I understand, from the—at least the preliminary numbers—both Chambers have authorized the President's request for the $6.4 billion. So in addition to that, previous appropriation bills have had language that provided for programs that are zero subsidy to get an additional 25 percent. Both of our guaranteed farm ownership and our direct farm ownership, for the first time ever, are going to be zero subsidy programs. So the answer to your question is yes, $6.4 billion, plus the 25 percent bump in both of those programs, will actually exceed $7 billion. And we expect that to be sufficient.

Mr. COSTA. And, historically, in terms of the level of lending activity that is taking place, would you say that the trends—that the appropriations reflect the demand out there?

Mr. BEYERHELM. Absolutely. As I mentioned in the previous 4 years, the programs have been oversubscribed. So we have always had periods——

Mr. COSTA. One could argue that maybe we should provide additional support for that effort then?

Mr. BEYERHELM. That would be up to this body to decide.

Mr. COSTA. No, I understand that part. Can you update us on where things are with the changes that were made as I stated as a result of the 2014 Farm Bill in terms of the relending provision of the microloan program. When that will be up and running?

Mr. BEYERHELM. Yes——

Mr. COSTA. Obviously, for young farmers and ranchers, that is a potential source of financing.

Mr. BEYERHELM. Yes. Thank you for that question. We are in the process of drafting proposed regulations on how to implement that among the other discretionary provisions of the farm bill. That is one of the things we expect to have some clarity on by October of this year.

Mr. COSTA. So before the end of this year?

Mr. BEYERHELM. Yes.

Mr. COSTA. That is important. When would the ability for application take place? Let us figure there are folks that are looking to maybe lease land or maybe purchase a farming entity, and they are looking at next year and are making decisions in the Fall. So in the timelines for the applications for those who would be interested, would it be in a timely enough fashion so that they could possibly be able to participate in 2015 with the advantage of that microloan?

Mr. BEYERHELM. We would hope so. Once the regulations have been drafted, we are going to have to work with——

Mr. COSTA. Yes, but there is a comment period, isn't there?

Mr. BEYERHELM. That is correct.

Mr. COSTA. I am trying to figure the timeline.

Mr. BEYERHELM. Yes, it will be close, to answer your question. We are going to make every effort, with any changes, to make them available to the 2015 lending season. But it will be close.

Mr. COSTA. Well, it is important, because if you get a loan in the middle of the year, you are past planting season, you are past a lot of decisions, depending upon the nature of the agricultural enterprise, obviously.

Mr. BEYERHELM. I think the good part about it is, is that our program is still going to be there for those that need that credit. So if there is somebody that needs financing——

Mr. COSTA. Have you done an an estimation of the potential demand out there for the microloans?

Mr. BEYERHELM. Well, as I mentioned earlier, we have been—we are right at the 7,200 mark right now. We did 3,500 the first year. And we are on pace to do about 4,500 this year. We would expect that demand to continue, especially one of the things we are going to do is increase the loan limits from $35,000 to $50,000—or at least propose to increase to $50,000.

Mr. COSTA. All right.

Mr. BEYERHELM. So that will increase the pool.

Mr. COSTA. Okay. Dr. Long Thompson, and thank you by the way for your previous service to our country as a Member of the House of Representatives. And it is good to see you here in your current role. In your opening statement, you talked about the nature of Farm Credit. But I would like you to give a better snapshot. For example, from the time when you served in Congress in the late 1980s, until today; you want to give a comparative analysis in 30 seconds or less?

Dr. LONG THOMPSON. I can do that in 30 seconds or less. The Farm Credit System today—the institutions that we regulate—are much more professional, much more financially sound. It is an incredibly strong system of lending institutions. And part of that is the result of changes that were made by Congress in the late 1980s. But in terms of underwriting standards and reaching out to

creditworthy eligible borrowers, I think the System has strengthened incredibly. And I am proud to be a regulator of the System.

Mr. COSTA. Thank you very much. My time has expired, Mr. Chairman.

The CHAIRMAN. Thank you. The gentleman's time has expired. I now recognize the gentleman from Iowa, Mr. King, for 5 minutes.

Mr. KING. Thank you, Mr. Chairman. I thank all the witnesses for your testimony. And I would turn first to Dr. Long Thompson. And I would like to just get some definitions down to understand the parameters that we are working with here. And could you define a little bit more clearly the mission statement of Farm Credit?

Dr. LONG THOMPSON. May I ask, the mission statement of the Farm Credit System or the mission statement of the Farm Credit Administration?

Mr. KING. I understand the mission statement of Farm Credit Administration. But the System and the—how to identify the borrowers.

Dr. LONG THOMPSON. The mission of the Farm Credit System is to provide credit to creditworthy eligible borrowers across the country for the purpose of making credit available for agriculture, but also for strengthening rural America.

Mr. KING. And does that include a definition for *small, beginning, young farmers?*

Dr. LONG THOMPSON. Yes.

Mr. KING. And so you just left that out. Does it also include for socially disadvantaged farmers?

Dr. LONG THOMPSON. All farmers who are creditworthy and eligible.

Mr. KING. Okay.

Dr. LONG THOMPSON. And, in fact, since my coming to the Board, we have adopted a policy that requires our examiners take a look at how the System is doing in this regard, for borrowers of all types. And they are to have a diversity and inclusion provision, both in their marketing—in reaching out to borrowers—but also in their human resources.

Mr. KING. All creditworthy, with a diversity and inclusion. Is this statement as written and approved by whom? Not Congress, I take it? How is this arrived at?

Dr. LONG THOMPSON. The statement—the diversity and inclusion regulation—that is a regulation that we issued.

Mr. KING. And who produces that document then? Who are the people that signoff on it?

Dr. LONG THOMPSON. It would be the Board of the Farm Credit Administration.

Mr. KING. Okay. And it is an authority that is at least presumed granted by Congress?

Dr. LONG THOMPSON. I missed that.

Mr. KING. It is an authority that is at least presumed granted by Congress to make that decision?

Dr. LONG THOMPSON. Yes. Yes.

Mr. KING. And you mentioned also that the share of the Farm Credit debt was 46 percent in your testimony?

Dr. LONG THOMPSON. Farm Credit real estate debt.

Mr. KING. Yes.

Dr. LONG THOMPSON. Overall, including production loans, it is about 41 percent.

Mr. KING. Well, what is the 46?

Dr. LONG THOMPSON. The 46 is real estate loans.

Mr. KING. Just real estate?

Dr. LONG THOMPSON. Yes.

Mr. KING. Okay. Can you tell us about the trend of Farm Credit? The 46 percent today, what would that have been if you would go back say 10 years? What has been the trend?

Dr. LONG THOMPSON. I will have to ask my staff. I don't have that trend for the last 10 years. But if you will give me a second, I think I can give you the answer.

Mr. KING. I would.

Dr. LONG THOMPSON. Thank you. Regarding total debt, and that would be real estate and operating loans, it is gone from about 35 percent to 41 percent in the last 10 years.

Mr. KING. Okay. And on the real estate debt, we would just anticipate, without turning back, a similar trend. And who holds the balance of that, if it is 46 percent in real estate? And where is the other 54 percent?

Dr. LONG THOMPSON. The majority of that comes from independent banks——

Mr. KING. Independent banks.

Dr. LONG THOMPSON.—or from banks—many from independent community banks.

Mr. KING. Okay. I would like to turn to Mr. Kauffman. Thank you very much. Mr. Kauffman, you testified that it is a relatively competitive environment—lending environment. That seemed like a qualifying word, and I would ask if you could define that to me. The word *relatively* seemed to be a qualifier.

Mr. KAUFFMAN. We have heard from our bank contacts that it is a competitive lending environment in the sense that there are—agricultural lending activity has been strong and repayment rates have been strong. So competitive in that sense that they have been—we have heard from bank contacts that not only have they been competitive perhaps with other commercial banks, but also with Farm Credit institutions that are lending in those areas overall.

Mr. KING. What about interest rates, do you know of any banks that are lending at a lower rate than Farm Credit?

Mr. KAUFFMAN. I can't speak to that specifically. I would say anecdotally, we have heard some bankers say that they may be reluctant in some cases to reduce interest rates beyond a certain point, taking a more cautious approach perhaps in some areas as it relates to particularly on the farm real estate side.

Mr. KING. Sounds like a qualified answer. Do you know of any cases, or even any anecdote about banks that are lending at a lower rate than Farm Credit?

Mr. KAUFFMAN. Again, I do not know of any specific cases.

Mr. KING. You do not. I would turn to Dr. Long Thompson. Do you?

Dr. LONG THOMPSON. I can tell you that I know of instances where that is the case. And I am wondering if you are expressing or leading to expressing concerns about interest rates that are

charged in the System? Because they are required to be competitive, but they are not to engage in predatory pricing.

Mr. KING. Dr. Long Thompson, I just—as our clock has run out, I will just conclude this. I am concerned about the competition side of this and the mission of providing credit, although I am grateful for the service that you all provide. Thank you very much, and I yield back.

Dr. LONG THOMPSON. May I answer?

Mr. KING. That is fine.

The CHAIRMAN. Go ahead.

Dr. LONG THOMPSON. Thank you. Whenever there is a concern expressed from someone across the country regarding predatory pricing in the System, we take that very seriously. And we do examine it, take a look at it. And if it were to occur, we certainly would then take the appropriate corrective action to get that corrected. But competitive is not by definition predatory, as you very well know.

Mr. KING. Agreed. Thank you.

The CHAIRMAN. The gentleman's time has expired. I recognize the gentleman from Oregon for 5 minutes.

Mr. SCHRADER. Thank you, Mr. Chairman. Dr. Long Thompson, how did Farm Credit Service, particularly Farmer Mac, fare during the recent recession, particularly compared to other banks and commercial institutions?

Dr. LONG THOMPSON. The Farm Credit System did very well, including Farmer Mac. Some of the challenges that they faced were access to capital in the markets, liquidity, but no issues regarding the safety and soundness of their particular operations.

Mr. SCHRADER. Did you lose——

Dr. LONG THOMPSON. They did very well——

Mr. SCHRADER. Did you lose any institutions under your purview as a result of the recession?

Dr. LONG THOMPSON. We did not lose any institutions as a result of the recession. There had been some mergers that have occurred since, but that was occurring beforehand.

Mr. SCHRADER. Right. When Dodd-Frank was written, this group and the entire Agriculture Committee spent a lot of time trying to differentiate between institutions of systemic risk and to protect end-users from overregulation. Similarly, in Dodd-Frank itself, a lot of the small independent banks were never part of the problem, we tried to make sure they were not burdened with burdensome regulations. And yet the Prudential Regulators have been frankly very overzealous. And I hear reports again and again how the small, independent folks are seeing the same degree of regulatory overreach that was only intended for these big systemic risk institutions. How has Farm Credit services fared in that System? How are you keeping your regulations under control, if I may ask?

Dr. LONG THOMPSON. Well, as you know, for the most part, the System was not included in Dodd-Frank reforms. And you know that very well. It is my sense that we are not over-regulating. But the one thing that we have to be very careful about in overseeing the Farm Credit System is that it doesn't have the potential for diversifying its portfolio in the same way that banking institutions are able to do. And so we have to be very conscious of what that

means in terms of things like capital requirements and liquidity. One of the reasons the System is strong is that the ag economy has been quite strong overall over the last 20 years. There have been some pockets of issues. But we take the regulatory responsibilities very seriously, recognizing that over-regulation can in fact impede their ability to do their job and fulfill their mission.

Mr. SCHRADER. Very good. Mr. Beyerhelm, to that point, I can confirm that the Pacific Northwest and our nursery industry was particularly hard hit in the recession. Our seed producers were particularly hard hit. Christmas trees producers are just trying to get their feet underneath them. How are they fairing in the Farm Credit System at this point in time?

Mr. BEYERHELM. I don't have specifics for that particular enterprise, but I can surely get those for you. Certainly, they are eligible enterprises for our loans, both our direct and guaranteed loans.

Mr. SCHRADER. All right. I appreciate that. And then could you explain a little bit about what you alluded to in your testimony, how a farmer graduates, if you will, to commercial lending. What do you see as your main role to encourage people to graduate? That is the way it is supposed to work. Could you explain that more for us?

Mr. BEYERHELM. Yes. Obviously, we don't compete with the commercial lending industry. So most of the customers who come to us, their balance sheets are not strong enough to go to commercial lending. Perhaps their cash flows don't have the—a debt repaying capacity. So what we do is try to work with them to improve their balance sheets, their cash flows and also their production skills. Our loan officers actually work very closely with them, provide technical assistance. And at any point during their tenure with us that we feel that those three indicators have risen to the level that commercial lenders will make them a loan, as you said, we politely ask them to go to a commercial lender, pay us off and move on to the next customer.

Mr. SCHRADER. And that is to make sure that your capital can flow onto the next young farmer or rancher coming in?

Mr. BEYERHELM. Absolutely.

Mr. SCHRADER. Good.

Mr. BEYERHELM. Yes. Yes.

Mr. SCHRADER. Okay. Mr. Kauffman, one of the problems on the Small Business Committee, and one of the problems we have seen there is that there is a lot of demand for small business loans, a lot of demand for Farm Credit Service loans. In tough economies, as people figure out they want to start a business, start a farm, or get their dad's ranch going again, one of the problems we have seen is that while creditworthiness of some of the loans have actually gotten a little better, there are far fewer loans made. The Small Business Administration is making bigger loans to fewer people. And the real small businesses sometimes have a tough time. They are still having a very tough time getting the credit they need. How would you compare that to what is going on with Farm Credit Services, the medium and slightly larger size ranch and farm operations? What does the portfolio look like for FSA?

Mr. KAUFFMAN. I would say in general from the commercial lending institutions, what we have seen has been some producers, in

terms of the scale of agriculture, capital requirements are quite large. I think that we have seen even the USDA Census of Agriculture has revealed there has been a bit of a shift to large producers, but also a number of increasing small producers. I think that there have been some small producers that have been able to obtain the credit that they need, albeit in some cases maybe needing to provide more collateral if they have—if they are perceived as being a more risky borrower.

Mr. SCHRADER. All right. Thank you. And I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman yields back his time. I now recognize the gentleman from Texas, Mr. Conaway, for 5 minutes.

Mr. CONAWAY. Thank you, Mr. Chairman. Lady and gentlemen, thank you for being here. Dr. Long Thompson, the FCA is currently working on a regulatory scheme to impose margin requirements on derivative transactions. We have just passed the House yesterday, H.R. 4413, which amends the CEA that would provide that initial and variation margin requirements shall not apply to a swap in which one of the counterparties to the swap is not a financial institution and qualifies for the end-user clearing exemption. If enacted into law, how would that change the FCA's efforts to impose margin requirements of end-users?

Dr. LONG THOMPSON. If you will give me just a minute, I want to turn to our General Counsel.

Mr. CONAWAY. Sure.

Dr. LONG THOMPSON. This is actually a very simple answer. It is going to be consistent with the law. And we will make sure that we are working with the other regulators. But the stage that we are in the process, there is nothing definitive for me to provide in terms of specifics.

Mr. CONAWAY. Okay. Well——

Dr. LONG THOMPSON. But we will make sure that it is consistent with the law.

Mr. CONAWAY. Okay. That is like art.

Dr. LONG THOMPSON. I am sorry. I missed that.

Mr. CONAWAY. I mean, that statement is like trying to decide what is pretty and what is not pretty. I mean, I understand——

Dr. LONG THOMPSON. It will be pretty. I promise you.

Mr. CONAWAY. Okay. Mr. Beyerhelm, you had a comment that you provide credit to creditor—borrowers. Can you give use the distinction between—or the difference between your words, not qualifying for commercial credit due to lender standards but otherwise creditworthy? What—can you help me understand that?

Mr. BEYERHELM. Well, most commercial lenders require a—some sort of equity position, maybe let them qualify—at least 30 to 40 percent equity position and a debt service capacity of probably 20, 25 percent in excess of what their expenses will be. So when a customer comes in and doesn't meet those qualifications, they can come to FSA. When I say they are creditworthy otherwise, that means they have a good credit history. They can show repayment, perhaps not at the 20 percent level but something less than that. And they don't have the required equity position to go to the commercial lender.

Mr. CONAWAY. Okay. All right. Also, Dr. Long Thompson, you are redoing the capital requirements. You have regulations out right now. Can you give me some sense of what the response has been from the regulated industry with respect to your changes?

Dr. LONG THOMPSON. At the stage of the process that we are in, I don't have any summarizing data on what the responses are, because it is still in the comment period.

Mr. CONAWAY. Okay. But—well, maybe some other panelists can get—thank you very much. I appreciate you being here. And I yield back.

Dr. LONG THOMPSON. Thank you.

The CHAIRMAN. The gentleman yields back his time. I now recognize the gentleman from Florida for 5 minutes, Mr. Yoho.

Mr. YOHO. Thank you, Mr. Chairman. Thank you, panelists, for being here. Agriculture is dear to my heart, because I like to eat, mainly. But I have been involved in it since I was about 16 years old. The Farm Credit Service or System has done a remarkable job. But I kind of want to expand on what Mr. King was bringing up about mission creep, have we gone over where we need to go with the Farm Credit System. Has it overstepped its boundaries, knowing when it first started in some form in 1916 when we had about 32 percent of the population of America involved in agriculture. Today, we have roughly maybe one percent right as agriculture as our source of income, with two percent of the Americans—America's population involved, or living on a farm. And the role seems like, of the Farm Credit System, has grown. I get—I don't want to say complaints. I get inquiries about the Farm Credit System competing with the small rural banks. And I want to build off what Mr. Schrader said, my fellow veterinarian here in Congress, on the rules and regulations of Dodd-Frank you brought up that you are pretty much excluded from those. All right. And the small community banks that they don't have a large portfolio. They are bound by those, and they are restricted by those. And it really put them at a disadvantage. And some of the conversations we have is that the Farm Credit System can be more competitive because of the operating expenses. How do you view that?

Dr. LONG THOMPSON. I think that is a very good question. And it has a certain complexity to it. My experience as a regulator of the System has informed me that there really hasn't been significant, if any, mission creep in the Farm Credit System. But it is a balancing act, because—and it is a balancing act not just for the System, but for the regulatory agency as well.

Mr. YOHO. Can I interrupt you? Let me ask you——

Dr. LONG THOMPSON. Sure.

Mr. YOHO. In your portfolio, I think you said 41 percent of your assets are in farm—or not assets—your loans are in agricultural land, correct?

Dr. LONG THOMPSON. No. What I said was——

Mr. YOHO. Then 46 percent was——

Dr. LONG THOMPSON. No. What I said was that of the farm loans across the country, 41 percent of those are made by the Farm Credit System.

Mr. YOHO. Okay. Go ahead then on what you were talking about as far as your mission.

Dr. LONG THOMPSON. And so the challenge for any regulatory body is to find the balance. We work very hard with a very professional staff of examiners, regulatory policy folks, lawyers, to ensure that whatever businesses engaged in by the System is consistent with the law. I think that the agency has done a good job of that.

Mr. YOHO. Mr.——

Dr. LONG THOMPSON. Yes, sir?

Mr. YOHO. Go ahead. And I was going to ask Mr. Kauffman his opinion on that.

Dr. LONG THOMPSON. Okay. But, in a market economy, as we have—in a capitalist economy, there is going to be competition. And I think that competition benefits—it benefits——

Mr. YOHO. Well, since you brought that up. In a market economy, in the free market, they are kind of—like a community bank, they are kind of dependent upon themselves. Whereas in the Farm Credit System, you have the backing of the United States Government. It seems that is not quite as fair or as equitable as it should be in the free market economy.

Dr. LONG THOMPSON. Well, let me clarify. The System that we regulate is private sector.

Mr. YOHO. Yes.

Dr. LONG THOMPSON. And it gets its funding by selling securities in the marketplace.

Mr. YOHO. But yet if you don't have to abide by Dodd-Frank financial regulations, you are talking about being fair. And my time is—we have about a minute left.

Dr. LONG THOMPSON. But we do have a book this thick of laws—of statutes that we have to ensure is followed by the Farm Credit System.

Mr. YOHO. I have heard from the other banks, they have one about this thick. Mr. Kauffman, what is your opinion on——

Dr. LONG THOMPSON. Ours is getting thicker.

Mr. KAUFFMAN. We do hear similar inquiries from community bankers asking similar questions. I would corroborate what Dr. Long Thompson had said in terms of the split between real estate and non-real estate at community banks. You do typically see a bit more lending activity in the non-real estate space. And that has been a trend that we have seen here recently. But we do hear similar inquiries from community bankers.

Mr. COSTA. Would the gentleman yield?

Mr. YOHO. Yes, sir.

Mr. COSTA. If I understand your questioning correctly, you are attempting to try to get a snapshot on the balance of the lending activity between the Farm Credit and between the private sector institutions, correct?

Mr. YOHO. Well, what I would like to do is kind of—do we need a Farm Credit System as big as we do now, compared to what we did when we had 32 percent of the population involved in farming——

Mr. COSTA. Right.

Mr. YOHO. And, today, we have less than one percent actively involved in farming.

Mr. COSTA. But with FSA, especially, there is a partnership.

Mr. YOHO. Right.

Mr. COSTA. If I understand it correctly, with the community banks that are the private sector that are banks made up of people we know in our communities——

Mr. YOHO. Right.

Mr. COSTA. You are providing in essence the secondary mortgages or the guarantees on these loans for the community banks, in many instances. Is that correct?

Mr. BEYERHELM. Yes, that is correct, up to—we do have a restriction requirement that they be family size farms. So to some extent, for the smaller operators. But for the larger operators, there would not be a comparable—an opportunity to participate in FSA programs.

Mr. COSTA. Mr. Chairman, can I ask something on family size farms?

The CHAIRMAN. I thank the gentleman for yielding.

Mr. YOHO. Yes, sir.

Mr. COSTA. On the family size farms, what is the definition of that? Is that just one person with a tractor, or——

Mr. BEYERHELM. I think it is what is pretty and not pretty question. A general definition of *family sized farm* is that the applicant themselves, whether it is a corporation or individual, whatever, provide the majority of the labor required and all of the management required to run the operation.

Mr. COSTA. Thank you.

Mr. BEYERHELM. That is the general definition.

The CHAIRMAN. The gentleman's time has expired. Just for clarification, Dr. Long Thompson, can you leave ag space at any point in time?

Dr. LONG THOMPSON. I missed that question.

The CHAIRMAN. Can you leave ag space at any point in time? That is your core mission, correct?

Dr. LONG THOMPSON. We are the regulator. The Farm Credit System——

The CHAIRMAN. Farm Credit System. I am——

Dr. LONG THOMPSON. Yes. They do have, as authorized by Congress, the ability to make rural housing loans. Beyond that—well, and then the title III lending authority is for rural electric co-ops, for telephone co-ops, for co-op business, various kinds of co-op business.

The CHAIRMAN. So what we are really talking about is a—sort of a broad definition of what constitutes agriculture *versus* non-agriculture portfolio. And I don't want to encroach on Mr. Roger's time. So I will recognize the gentleman from Alabama for 5 minutes.

Mr. ROGERS. Thank you, Mr. Chairman. That is what I was going to ask about. And I was late. And I am sorry. And I know that the Chairman visited this topic earlier. But one—the primary criticisms I get about the Farm Credit System is issuing loans in non-agriculture. And so do you know what percentage of the loan portfolio the Farm Credit System is issued to non-farm entities?

Dr. LONG THOMPSON. I think it probably would be best for me to get a detailed breakdown for you. But it is primarily agriculture and ag related. It is agriculture—and let me also say that, even though the System did not fall for the most part under the jurisdic-

tion of Dodd-Frank, there are other kinds of rules that statute requires—for example, the territories, the districts that are established. So there are a number of restrictions in the Farm Credit System that simply are not restrictions in the banking sector. And I also think that there is a very strong case to be made for a group of farmers going together and setting up a cooperative model of lending, particularly when there is not always access in traditional banking.

[The information referred to is located on p. 91.]

Mr. ROGERS. Now, I represent a very rural Congressional district. There is access to credit in our communities. I have been a supporter of the Farm Credit System. But, it is pretty hard for me to explain—I can't explain why you are financing a merger deal with Verizon, or the Farm Credit System is. I recognize that from a making money standpoint you want to do that, but—and while it is not illegal to do it——

Dr. LONG THOMPSON. Yes.

Mr. ROGERS. Why would you do it?

Dr. LONG THOMPSON. Well——

Mr. ROGERS. When you and Mr. Kauffman talked about what you are really there for is to take the shaky young farmer and help to get him on stable footing so they can then go into the commercial lending, why would Farm Credit get outside the farm world for lending?

Dr. LONG THOMPSON. Verizon does provide service to rural communities. And in the title III lending authority, loans are made for co-op-owned rural utility services that are member-owned. And this similar-entity provision that was included in the law back in the early 1990s was included for the purpose of mitigating risk in a lending institution's portfolio. If you felt that it was important to remove that particular provision, Congress could certainly do that.

Mr. ROGERS. Yes, I think that we may have to visit that, because this really is pretty indefensible in my world. So with that, I thank you, Mr. Chairman.

The CHAIRMAN. The gentleman yields back his time. I see no further—we have one more Member, the gentlelady from New Mexico is recognized for 5 minutes.

Ms. LUJAN GRISHAM. Thank you very much, Mr. Chairman. And I want to thank the panel for your testimony and presence here today. Mr. Beyerhelm, I want to talk about the loan application process and tie it to what I know many states are concerned about and you are concerned about as well, which is the graying or the aging of our farmers and ranchers. We have in New Mexico, which I am sure you are aware, the highest percentage of older farmers and ranchers who are age 65 and up, at 37 percent. That is seven points higher than the national average. Further, we expect that ½ of those 65 and older farmers to retire over the next decade. So we are very interested in our state at making sure that there is a sense of urgency by USDA, a sense of urgency by everybody in the state to do what we can to grow, if you will pardon the pun, the younger farmers and ranchers an interest in the agricultural industry. And I know that you have ramped up your efforts to reach out to this demographic. But I continue to hear from young

farmers and ranchers that it is not enough, that the application process for loans and support is arduous at best.

And I want to give you a couple of examples. And if you could give me some specifics about what we might do to make that simpler, more effective and to really encourage folks to get the resources that they need and the educational support and expertise that they need to actually enter into the industry. So, for example, in New Mexico, even if you go online—and I realize that you have now created an online sort of resource directory, you have to be able to go online. But even then, you are still going to have to make an application. But, you can't do any of it online. You have to go in-person to an office. In New Mexico, there are only four offices. They are all in the southern part of the state. That means for some people, they are going to have to make a 6, 7, 8 hour drive, make an appointment at one of those four offices, and then, as I understand it, even if you look at the sort of guide on the online application, you are talking about making several trips to that loan office over periods of several months. And what happens is that people give up. And they don't get access to the support, the expertise, the credit, the resources or anything else to engage in this industry. Can you give me a sense about what we might do in the rural states to make sure that we are doing more than just creating an online resource directory? And I don't want to minimize that that is a step in the right direction. But it isn't getting to this demographic or actually getting what they need so that they enter the agricultural business.

Mr. BEYERHELM. Yes. Thank you so much for that. And you are entirely correct. I think the situation is exacerbated a little bit when you get out into the West and you have these huge geographical regions. And then when you combine that with a continued budget constrained environment in which we have lost 25 percent of our employees in the last 4 years and had to restrict our footprint a little bit in rural America. So to try to respond to your question, one of the things are we are working very hard to create an online application to reduce some of the repeated need that you have to go to the office. So it is our goal and our hope that in the very near future that somebody is going to be able to apply, going to be able to do a lot of the pre-stuff—at some point, we have to have that face-to-face.

Ms. LUJAN GRISHAM. And I appreciate that. Can you give me a sense of the timeframe? I don't mean to sound like I am pushing back. And I know that you have talked about the streamline process in your testimony, but that is only for repeat loan applicants. I can do a loan, and I can get prescreened at my bank. I could do it while I am sitting here in this Committee, and just pull up my personal account information and send a loan application to my bank of choice. And probably, before I finish my remaining 46 seconds, I would get an answer about how eligible I am and what else they need. We could be using colleges and universities, and we could be using extension services, and we could be using state government partners and local government partners, so that you have a much broader footprint in this regard. So talk to me, if you can—I know I am over time, Mr. Chairman—about how long before you get the entire application online, and please tell me your thinking

about broadening your partnerships to achieve the goals that we are interested in.

Mr. BEYERHELM. Yes. As I said, I can't give you an exact timeline on the online application. It would certainly be my hope that sometime in the next 12 months we would have that done. The other thing that we are doing, in the farm bill, we were given authority to do pilot projects. And one of the things we want to look at is exactly what you are talking about is partnering with CDFIs, local CBOs and have those folks help us in reaching out to individuals in remote areas, actually underwriting loans, bringing to those to actually leverage their expertise. So I am glad you mentioned that, because that is one of our objectives under the pilot project authority.

Ms. LUJAN GRISHAM. Mr. Chairman, if I might, can I make one quick statement?

Thank you, Mr. Chairman. And I really appreciate that. And, I am probably going to send you in this terrible circle. I am an old bureaucrat myself. And I know that we can just go in circles—finding the right size. So I applaud that effort. And I know that we want to make sure that the loans that we provide are creditworthy. But you have to also make this burden much smaller, because you could certainly make the argument that instead of having to figure out these partners and going out to nonprofits and funding them and supporting them to do the loan application, wouldn't it be much smarter and swifter to make it less burdensome so that we don't need so much stuff, without minimizing that you have to assess the risk? So I just want to push that balance is great, but urgency really is important here. And we stand ready to help you in any way that we can to make the difference.

Mr. BEYERHELM. Yes. And thank you very much for that. And no, certainly, we will continue to look at ways to streamline the process. I do want to say though that because we make loans that are very highly leveraged—I mean, we can actually—if somebody wants to borrow $200,000 to buy a $200,000 piece of property, we can do the whole 100 percent financing. And their cash flow may have a three percent margin in it. So as a consequence we do have to spend some time, for the taxpayer's benefit, but even more importantly for the customer's benefit that we do not provide them financing that they cannot repay and then wreck their credit. So there is a fine line in there somewhere. But I appreciate your comments. And we will look into it.

The CHAIRMAN. I thank the gentlelady. The gentlelady from New Mexico makes a good point—most of us on this Committee serve a rural constituency. I would think that she brings a unique perspective in that she serves a remote constituency, and we have seen such consolidation with respect to FSA office closures and so on. The irony in this whole thing is that rural broadband has not kept pace. So it is that much more challenging. And the point that she has made is very well noted.

So with that, I will recognize the gentleman from Virginia for 5 minutes, Mr.—no. Okay. Seeing no further requests for time, we will dismiss this panel. Thank you all very much. We appreciate your testimony. And we certainly appreciate you being here. And we will prepare for the next panel.

Dr. LONG THOMPSON. Thank you.

The CHAIRMAN. In the interest of time, as we prepare the second panel, I would just go on ahead and take a minute to introduce those individuals. This is a bigger panel than the first one. We have a total of five. Mr. Bob Frazee, President and CEO of MidAtlantic Farm Credit, Westminster, Maryland; Mr. Timothy L. Buzby, President and CEO, Farmer Mac; Mr. Leonard Wolfe, President and CEO, United Bank & Trust of Marysville, Kansas, on behalf of the American Bankers Association; Mr. Sean H. Williams, President and CEO of The First National Bank of Wynne, Wynne, Arkansas, on behalf of the Independent Community Bankers of America; and, finally, Mr. Brett Melone, Loan Officer, California FarmLink, Santa Cruz, California, on behalf of the National Sustainable Agriculture Coalition.

And it appears that we have all of our panel members seated. I would remind our panelists, just as I did the first panel, green is go. You are good to go. When you see yellow, step on the gas. And red indicates your time has expired.

So with that said, we will start by introducing Mr. Bob Frazee, President and CEO, MidAtlantic Farm Credit, ACA, Westminster, Maryland, on behalf of the Farm Credit System. Mr. Frazee, you are recognized for 5 minutes.

STATEMENT OF BOB FRAZEE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MIDATLANTIC FARM CREDIT, ACA, WESTMINSTER, MD; ON BEHALF OF FARM CREDIT SYSTEM

Mr. FRAZEE. Thank you, Mr. Chairman, and Members of the Subcommittee. I appreciate the opportunity to testify today on behalf of the Farm Credit System.

At MidAtlantic Farm Credit, we are part of the nationwide Farm Credit System that is privately owned by farmers, ranchers, agricultural cooperatives, rural utilities and others in rural America. MidAtlantic is owned by more than 10,000 farmers that borrow from us in Delaware, parts of Maryland, West Virginia, Virginia and Pennsylvania. I report to an 18 member board, 16 of whom are farmers elected by the borrower-owners of our cooperative. The Board sets the policies that guide our institution.

Farm Credit funds its lending by marketing System-wide debt securities to the investing public. We do not have access to deposits guaranteed by the FDIC and backed by the U.S. Treasury as a source of funding. The Farm Credit System remains financially strong. Our earnings have been good. Loan volume has continued to grow. And our capital at the end of the first quarter this year was 16.6 percent of total assets. The investors that buy our bonds want to see the strength so that they will continue to make their capital available to farmers, ranchers and rural America through us.

Being a cooperative, we share our profits directly through patronage dividends with the farmers who borrow from us. In 2013, MidAtlantic distributed nearly $19 million, and the System over $1 billion in earnings as patronage dividends. This puts money back in the pockets of farmers, and that supports rural communities.

System institutions are regulated by the Farm Credit Administration. And I am on the receiving end of their attention, so I will

let you know that they are doing their job thoroughly. The Farm Credit Act makes clear that our responsibility is to meet the needs of all types of agricultural producers that have a basis for credit. Our customer base reflects the fact that farming has changed dramatically since the System was established almost 100 years ago. Our territory contains a diversity of farming operation that is today's agriculture. We serve Maryland and Delaware poultry producing operations that are sophisticated, complex business, as well as startup vegetable growers in Virginia who are producing food for farmer's markets right here in Washington.

If agriculture is going to be able to continue to feed a planet of nine billion people in the year 2050, it is important that all types, all sizes of farms have access to capital and the infrastructure to support them. We are focused on doing all that we can to help with that. One way we are helping is through the StartRight Program we created in 2008 to address the challenges faced by young, beginning and small agricultural producers. Last year, we developed a Farm Fresh Financing Program, created to help producers involved in local foods and sustainable agriculture.

An example of Farm Fresh Financing is the Urban Tree Connection in Chester, Pennsylvania. They have been building gardens in vacant city lots for over 10 years, growing fresh produce for their neighborhoods. We help them purchase equipment and have provided a revolving line of credit so that they will continue to grow and serve more communities.

As of the end of May, we had over $57 million in loans in the StartRight Program and over $83 million in Farm Fresh Financing. Every Farm Credit Association has programs that are specifically targeted to serve these young, beginning and small farmers. During 2013, the System made $8.3 billion in new loans to young farmer, and almost $11 billion to beginning farmers and $11.4 billion to small farmers. System institutions also deployed capital in support of rural communities, making investments in our borrower's communities that will help to make them places where their children and grandchildren want to live. For example, the Farm Credit System provided $140 million to fund a rural business investment company that will begin operations this summer to save and create new jobs in rural communities.

We are also very proud of a $250,000 Farm Credit grant that has enabled the Farmer Veteran Coalition to take a labeling program that was started in Kentucky to a national level. This will allow consumers to choose products produced by farmers that are veterans when they make purchases.

Now, agriculture has experienced some very good years recently. However, some sectors have experienced stress, as we have heard earlier today. We have seen the livestock sector that was hit hard by high feed costs, but we have seen improvements there recently. In the Midwest, there have been issues around land value inflation. Our institutions took aggressive steps to manage their lending programs to avoid taking on increased credit risk as land values have increased. We make our credit decisions based on repayment capacity, not inflating collateral values.

Drought conditions are impacting many parts of the country. In California, the third consecutive year of drought and water restric-

tions pose significant risk to producers. Institutions there tell us that borrower's liquidity will be helpful this year. But another dry year in 2015 is likely to create financial adversity for them. We will work with those customers on a case by case basis to help them.

In conclusion, the Farm Credit System continues to make credit available to all segments of agriculture. We cover the expense of being regulated by the government. We pay insurance premiums to protect investors. And we rely on continued access to the debt markets and a built in oversight mechanism for our member-owners.

Mr. Chairman, thank you again for the opportunity to testify. And I will be pleased to respond to your questions.

[The prepared statement of Mr. Frazee follows:]

PREPARED STATEMENT OF BOB FRAZEE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MIDATLANTIC FARM CREDIT, ACA, WESTMINSTER, MD; ON BEHALF OF FARM CREDIT SYSTEM

Mr. Chairman, and Members of the Subcommittee, thank you for the opportunity to testify today on behalf of the Farm Credit System. My name is Bob Frazee and I am President and CEO of MidAtlantic Farm Credit.

MidAtlantic is part of the nationwide Farm Credit System. My remarks today will provide some background on the Farm Credit System, an overview of current credit conditions, and comments on how Farm Credit is meeting our mission, and serving the credit needs of agriculture and rural communities.

Background on the Farm Credit System

The Farm Credit System is a federally chartered network of borrower-owned lending institutions. Established in 1916, the Farm Credit System is comprised of 82 privately owned institutions. This includes four wholesale banks and 78 direct lending local associations. Farmers, ranchers, agricultural cooperatives, rural utilities and others in rural America cooperatively own all of these institutions. The four wholesale banks include CoBank. In addition to lending to Farm Credit associations, CoBank lends to agricultural, rural electric and telephone cooperatives, as well as rural water and sewer systems, broadband providers, agribusiness and to support exports. Farm Credit's mission is to provide sound and dependable credit and other related financial services to our owners and others consistent with the eligibility criteria set out in the Farm Credit Act.

MidAtlantic is a direct lending association. We are owned by more than 10,000 farmers that borrow from us in Delaware, and parts of Maryland, West Virginia, Virginia and Pennsylvania. As President and CEO, I report to an 18 member board of directors. Sixteen of these directors are farmers elected by the borrower-owners of our cooperative. In addition to elected borrower-owners, each System institution is required to have at least one appointed outside director on their board that has financial expertise. At MidAtlantic, we have chosen to have two appointed directors. In no case are employees allowed to serve as directors of our lending institutions.

The board of directors is responsible for setting the policies that guide how we run our institution and serve our marketplace. They approve the cooperative's capitalization plan consistent with Federal regulations and ensure that management makes available loan products and related financial services appropriate to the unique needs of agriculture in the territory the association serves.

Each Farm Credit association obtains funds for its lending programs through one of the four Farm Credit banks. At MidAtlantic, we get our funding through AgFirst Farm Credit Bank, located in Columbia, South Carolina. AgFirst is owned by MidAtlantic and 18 other associations.

The four Farm Credit System banks cooperatively own the Federal Farm Credit Banks Funding Corporation. The Funding Corporation, as agent for the banks, markets to the investing public the System-wide debt securities that are used to fund the lending operations of all Farm Credit System institutions. Unlike commercial banks, Farm Credit institutions do not have access to secured deposits guaranteed by the Federal Deposit Insurance Corporation and backed by the U.S. Treasury as a source of funding.

Regulatory Oversight by the Farm Credit Administration

All Farm Credit System institutions are regulated by the Farm Credit Administration (FCA). The FCA is an arm's-length, independent safety and soundness regu-

lator. The agency's three Board members are nominated by the President and confirmed by the Senate. The FCA has the oversight and enforcement powers that other Federal financial regulators have in order to ensure that Farm Credit institutions operate in a safe and sound manner. FCA examiners are required to be engaged with every System institution at least once every eighteen months. As one who is on the receiving end of that attention, you should feel comfortable that they are doing their job thoroughly.

The terms of two of the three FCA board members have now expired. I understand that this Committee is not directly involved in the nomination and confirmation process; however, we urge the Committee to encourage the White House to bring forward nominees to the Senate in a timely basis.

The Farm Credit System's mission, ownership structure and authorizing legislation are unique among financial institutions. It is critically important that Farm Credit's safety and soundness regulator understands our mission and what it takes to be successful in accomplishing that mission. Sometimes they need to be reminded of that, so we appreciate very much the language included in the farm bill reminding the regulator that the System's unique cooperative structure should be taken into consideration as they promulgate rules.

The System's safety and soundness also is overseen by the Farm Credit System Insurance Corporation (FCSIC). FCSIC administers the Farm Credit Insurance Fund. The Fund and the operations of the Insurance Corporation are supported by premiums paid by Farm Credit institutions every year. The Fund is there to protect investors in System debt against loss of their principle and interest to the extent there are funds available in the Fund. There is no direct taxpayer backstop for the Fund. The Farm Credit Act sets the funding goal for the Fund at 2% of the aggregate outstanding insured obligations of the System. FCSIC also has the authority to examine System institutions and would act as the conservator or receiver of a System institution should one fail.

Fulfilling Farm Credit's Mission of Service to U.S. Agriculture and Rural America

All Farm Credit institutions are focused on accomplishing the mission established for us by Congress: to serve agriculture and rural America. Our cooperative structure and governance is designed specifically to ensure that our lending and related financial service activities are driven by the needs of our borrower-owners and to ensure that there is a reliable and competitive credit source available to agriculture that America's farmers and ranchers own and control. Our practice is to engage our customers in a consultative lending relationship, using our accumulated expertise and knowledge of agriculture and finance to craft long-term relationships. Our services are delivered in the manner that best suits our customers' needs—whether that means talking to them and completing loan documents at a poultry farmer's kitchen table, online while a vegetable producer is working in the field, or in the conference room of a regional agribusiness.

The diversity found in our customer base is indicative of the fact that farming has changed dramatically since the Farm Credit System was established almost 100 years ago. We are constantly evaluating our programs to ensure that we are able to serve the full breadth of agriculture. Much has been said and written about how agriculture needs to be prepared to feed a planet of nine billion people by the year 2050. Very little focus has been given to the amount of capital that will be needed to make sure our agriculture and infrastructure that supports it will be up to the task. Many have different visions regarding what agriculture should look like to accomplish this. Our job is to be positioned to meet the needs of each—whether small and local, large and national, traditional or organic. As the Farm Credit Act makes clear, our responsibility is to meet the needs of all types of agricultural producers that have a basis for credit.

In our territory at MidAtlantic, we see the diversity that is today's agriculture first hand. We serve some of the premier poultry producing operations in the nation. These are sophisticated, complex businesses with tight margins and substantial credit needs. Our staff understands the needs of this industry and works closely with them on a whole host of issues. On the other end of the spectrum, we serve the needs of the Amish farming community in Pennsylvania, financing business improvements like solar panels that provide energy to their farms. In between those extremes are customers and businesses with similarly varied needs, from entrepreneurs working to develop a wine industry in Maryland, to dairy farmers in Delaware, to fruit and vegetable growers in Virginia producing food for local farmers' markets right here in Washington, D.C.

Our experience with this large swath of agriculture also gives us the knowledge, insight and expertise to develop special programs targeted at farmers who may need

special help. We created the StartRight program in 2008, which is a suite of loan products specifically designed to address the challenges faced by young, beginning and small agricultural producers. Just last year, we developed a Farm Fresh Financing program, created to help producers committed to local foods and sustainable agriculture. As of the end of May, we had over $57 million in loans in the StartRight program, and over $83 million in loans in Farm Fresh Financing. I'd like to give you two examples of the types of businesses and organizations that these loans help:

The Urban Tree Connection in Chester, Pennsylvania has been building gardens in vacant city lots for over 10 years, growing both fresh produce for the neighborhoods, as well as growing a sense of community among neighbors. Farm Credit provided funding to help them purchase equipment. We also provided a revolving line of credit so that they could continue to grow and serve more communities. Since its inception, Urban Tree Farm has partnered with several additional companies to help them meet their community goals, and Farm Credit is currently talking to them about financing options.

Groundworks Farm in Pittsville, Maryland is another example. Owners Margaret Evans and Kevin Brown didn't grow up on farms, but they knew farming is what they wanted to do with their lives. Farm Credit helped them buy a small farm on the Eastern Shore of Maryland to grow produce and offer shares in their CSA, a Community Supported Agriculture farm. Last year, they offered almost 150 shares in their farm to local residents.

It should be of no surprise to the Committee that when you look across Farm Credit's loan portfolio you will see represented in it the broad array of operations that are U.S. agriculture. The Farm Credit Act was designed to ensure that we can continue to meet the needs of agriculture, cooperatives and rural infrastructure as they have developed. Parts of the law have not been updated for over forty years, and it can be challenging at times for us to continue to fulfill that mission when old law has to be applied in a very changed world.

Sometimes when changes in law are made, they take time to get implemented. Back in the 2002 Farm Bill Congress authorized the formation of Rural Business Investment Companies (RBIC) and made clear that Farm Credit institutions could create and invest in these entities to further the goal of making available equity capital for rural entrepreneurs. It took additional changes in the law and final regulations that were not completed until 2013 for our institutions to be able to put this authority to work for rural America. This summer a Farm Credit System funded RBIC will begin operations thanks to a commitment of about $140 million from Farm Credit to capitalize the new effort. This will mean jobs saved and jobs created in rural communities.

We also are very proud of our partnership with the Farmer Veteran Coalition to serve veterans involved in agriculture. As the result of a $250,000 grant from the Farm Credit System, farmers who are veterans now have access to a national labeling program that will allow consumers to choose products they know are produced by farmers that are veterans when they make purchases. These funds facilitated moving this program from one operated only in the state of Kentucky to a national program.

Our cooperative structure ensures that our focus remains on the success of our owners rather than on achieving quarterly returns to impress stockholders. When our customer-owners achieve success, our business will succeed as well. Farm Credit's lending relationship with our member-borrowers is based on constructive credit over the long haul—we make loans, retain loans and service loans. Farm Credit does not enter and exit agricultural lending as farm profitability waxes and wanes.

Distributing Profits to Farmers Through Patronage

Our commitment to our borrower-owners' business success is demonstrated further by the fact that we share our profits directly through patronage dividends with the farmers who borrow from us. Each year, MidAtlantic's board of directors makes a determination based on our profitability and financial strength as to what portion of our net earnings will be returned to our members who borrow from us.

In 2013, MidAtlantic distributed more than $18.9 million in earnings as patronage dividends to the member-borrowers of our cooperative. In total, the Farm Credit System in 2013 distributed over $1 billion in patronage. This patronage distribution puts money back in the pockets of farmers. It is a rural stimulus that allows our customer-owners to re-invest in their own operations and to support rural communities through local spending.

Farm Credit's Financial Strength

The Farm Credit System remains very strong financially. The System's combined net income was $4.64 billion for 2013, and we are pleased to report that in the first quarter of 2014, the System's net income was nearly $1.1 billion. Nationwide, Farm Credit ended 2013 with a loan portfolio of about $201 billion, and we added another $3.5 billion in loans during the first quarter of this year. Our capital position exceeds that of most every other financial institution. At the end of the first quarter of this year, the System had just over $43 billion of capital, or 16.6 percent of total assets. This level of capital substantially exceeds that required by our regulator. This means that the investors that continue to make their capital available to farmers, ranchers and rural America through us should feel secure that they will be repaid.

Overall Farm Credit Loan Portfolio

As I noted before, at the end of the first quarter of this year we had outstanding about $204.5 billion in loans. To give you some perspective on the breadth of that portfolio of loans, that total was comprised of about $93 billion in real estate mortgage loans, $42 billion in production loans, $32 billion in agribusiness loans, $15.6 billion in energy and water and sewer, $6.5 billion in rural home loans and about $4.3 billion in communications loans. In addition we supported exports with $4.7 billion in financing.

Consistent with our authority under the Farm Credit Act, we are engaged in the rural community beyond agriculture. Because of the System's capital strength, institutions are also making investments that support the quality of life in rural communities. Institutions have invested in bonds issued to support critical care hospitals, nursing facilities, congregate housing for the elderly, and schools. Because our owners understand the needs of their communities, these investments demonstrate their commitment to making their hometowns the places where their children and grandchildren will want to live.

A Commitment to Serving Young, Beginning and Small Farmers

Every Farm Credit association must have programs in place targeted specifically at meeting the needs of three special categories of borrowers: those that are young, those that are beginning in farming, and those that are small farmers. Our regulator sets the definitions for each of these categories. Young farmers are defined as those 35 years old or younger. Beginning farmers are those with 10 or fewer years of farming experience. In the case of small farmers, we are required to look specifically at the gross farm sales of the individual producers. Small farmers are those with less than $250,000 in annual gross farm sales.

Each institution is required to report on their lending activity to these individual categories of producers. This data is not additive since individuals may fall into more than one category. During 2013 Farm Credit institutions made $8.3 billion in new loans to young farmers, almost $11 billion in new loans to beginning farmers and $11.4 billion to small farmers.

We work hard to serve the needs of young, beginning and small farmers. Across the country we do this not only by fulfilling their credit needs but also by supporting training and education programs, hosting seminars on intergenerational transfer of family farms, on risk management techniques and establishing and maintaining effective business plans. We are engaged across the spectrum with those entering agriculture whether they are focused on organic, sustainable, or local food related operations, direct-to-retail, or any other emerging business models. Our trade association, The Farm Credit Council, has been actively engaged with the support of USDA in reviewing the effectiveness of financial skills training for young and beginning farmers and encouraging the development of new tools that will help ensure those starting out in agriculture do so with the improved business management skills that are so necessary for farm businesses to be successful over the long term.

Current Conditions in Agriculture

Agriculture has experienced some very good years recently. As you know, however, several sectors have seen stress. We have seen many in what we call the green industry—sod, nursery and ornamental growers and greenhouse—struggle alongside the struggling housing industry. The stagnant housing sector also affected the timber industry. While the protein sector was hit by high feed costs, we have seen improvements recently. In the Midwest, there has been considerable attention paid to land value inflation. Our institutions early on took aggressive steps to manage their lending programs so as to not take on increased credit risk exposure as land values increased similar to what some lenders did during the housing bubble. Farm Credit System institutions approach their markets prudently. Caps were placed on lending

against land based on realistic projections regarding commodity prices. We make credit decisions based on the repayment capacity of the individual borrower rather than the inflating value of the collateral. Because we hold virtually all of our loans on our own balance sheet, we have a strong interest in seeing that our customers are successful and prudent in their own risk-taking, including the purchase and financing of farm real estate.

Crop Insurance

Crop insurance remains an extremely important risk management tool for farmers throughout the country. We appreciate very much that the farm bill provided more crop insurance options and ensured new policies will be made available for specialty crops. We believe that it is important as a lender to agriculture that we know our customers have insured their production. This protects the farmer and it protects the lender as we provide credit to farmers to cover their operating expenses. A strong, effective, fully funded Federal Crop Insurance Program is vitally important to maintaining credit flows to agriculture. We look forward to providing input as implementing regulations are developed and proposed.

Drought Conditions

Our institutions continue to monitor drought conditions in parts of Texas, Oklahoma, Kansas, New Mexico and particularly in California. While there has been some improvement in certain areas of the country, severe conditions still exist. I will address California separately but across all Farm Credit institutions it is important to note that in each situation we assess the circumstances of individual borrowers adversely impacted by weather conditions and work with them accordingly.

California is now in its third consecutive year of drought conditions and experiencing water restrictions to most areas of the state. This situation poses significant risk to agricultural production across the state in 2014, with ramifications into 2015 and beyond. It is fortunate that California farmers and agricultural cooperatives strengthened their balance sheets coming in to the current situation and are in a better overall financial position to withstand drought-related business impacts.

The drought's impact differs from region to region. Farm Credit institutions in California assess the drought's impacts by understanding the specific and unique circumstances of each customer. Our institutions then work collaboratively with individual borrowers who are experiencing distress related to the drought.

Overall, high grower liquidity, coupled with relatively strong commodity prices mean most agricultural producers should be able to adjust their plantings and their feed rations for livestock in the near term. It also is fortunate that the agricultural sector has become much more sophisticated in utilizing conservation measures to more efficiently use the water they have. However, the continuation of drought conditions risks adverse impacts on reserve groundwater storage and a substantial increase in groundwater overdraft. If this results, there will be substantial long-term costs of groundwater overdraft that are yet to be determined. Furthermore, if another critically dry year occurs in 2015, studies suggest the impacts likely will be much more severe, including reduction in water availability, crop acres and farm related employment. This will require close monitoring and early coordination among all interested parties to manage through without significant disruption.

The Farm Credit System remains well positioned to meet borrowing needs of agricultural producers impacted by the drought. The System's role is to stand by its customers and it will continue to fulfill that role in a safe and sound manner. This includes working collaboratively with individual borrowers who are experiencing financial distress related to the drought. Whatever the challenges presented by the drought, access to credit will not be one of them.

Conclusion

The Farm Credit System remains financially strong, economically vital, and focused on fulfilling its mission of service to U.S. agriculture and rural America. We continue to make credit available to all segments of agriculture, including commercial producers as well as young, beginning and small farmers and ranchers. We support agricultural cooperatives, rural infrastructure and the marketing channels that agriculture depends on to sell their product and we serve the needs of rural communities to the extent our authority permits. We are proud of our commitment to rural America.

There are no Federal dollars invested in the Farm Credit System. We pay for the expense of being regulated by the Federal Government through assessments on all Farm Credit System institutions. We pay insurance premiums to provide protection for those who invest in our debt securities. To continue serving our mission, we rely on continued access to the national debt markets and an independent, arm's-length regulator that comprehends the unique requirements of our cooperative structure

and agriculture. In addition to being closely regulated, we have the built-in oversight mechanism of our member-owners holding our feet to the fire to keep service quality high while protecting their equity in their cooperative.

Mr. Chairman, thank you again for the opportunity to testify today on behalf of the Farm Credit System. I will be pleased to respond to your questions.

The CHAIRMAN. Thank you, Mr. Frazee. I now recognize Mr. Timothy L. Buzby, President and CEO of Farmer Mac. You are recognized for 5 minutes.

STATEMENT OF TIMOTHY L. BUZBY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FEDERAL AGRICULTURAL MORTGAGE CORPORATION (FARMER MAC), WASHINGTON, D.C.

Mr. BUZBY. Chairman Crawford, and distinguished Members of the Subcommittee, thank you for your invitation to appear today to testify on behalf of the Federal Agricultural Mortgage Corporation, which is commonly known as Farmer Mac. My name is Tim Buzby, and I am the President and CEO of Farmer Mac.

Farmer Mac exists to deliver capital and liquidity to rural America, and offers a variety of financing options tailored to the needs of its customers, America's rural lenders. In Farmer Mac's role as the secondary market for rural America, we work closely with all types and sizes of rural lenders. Through alliances and partnerships, we work with over 900 institutions, including commercial and community banks, Farm Credit System institutions, insurance companies and rural electric lender cooperatives. By working with such a vast network, Farmer Mac introduces additional competition into the marketplace to ensure that your constituents are receiving the lowest interest rates and most favorable terms possible for their financing needs.

To fund the needs of our lending partners, Farmer Mac raises money in the capital markets as investors have looked to Farmer Mac as one vehicle to invest in rural America. Investors are attracted to the fact that today's agricultural producers are more efficient and productive than ever, more sophisticated in their financing arrangements and are providing quality commodities at competitive prices.

One indication of this interest in the investment of rural America is regular demand for Farmer Mac's debt and equity securities. As an example, Farmer Mac has seen great demand in its auction of over $250 million of securities during just the past 3 months. These securities have attracted competitive bids from multiple financial institutions, driving down Farmer Mac's cost of funds. Lower cost funding for Farmer Mac directly benefits your farmers, ranchers and rural utility cooperatives in the form of lower interest rates on products financed by Farmer Mac.

With regard to credit, the quality of Farmer Mac's portfolio remains a great story. We are extremely proud of our credit profile. And it will continue to be the cornerstone of our success in the future. Currently, our overall borrower delinquency rate on the loans in our $14.1 billion portfolio is only ⅕ of 1 percent. That said, Farmer Mac understands that agriculture is cyclical with many diverse industries that respond in different ways to changes and economic conditions. We take pride in the diversified nature of our loan portfolio that ranges from almond groves in California to wheat, corn and soybean crops in the Midwest, and from cattle

ranches in the Southwest to electric distribution cooperatives in the Southeast and across America.

We have found over the years that this diversification serves us well as the inevitable cycles of weather and commodity prices impact profits in agricultural industries across geographies.

As we look forward, although farm incomes are projected to decrease in 2014 compared to 2013, they are still very high from a historical perspective and will be above the 10 year average. In Farmer Mac's experience, farmers and ranchers today generally have stronger balance sheets than in the past, with higher working capital and lower leverage. In the agricultural lending space, there is great competition, particularly for the most successful producers who have become more sophisticated in their financing and are able to demand lower rates and more favorable terms. Very often, these borrowers are prudently choosing to finance farm purchases and refinancings with long-term fixed rate mortgages to lock in low and known interest costs.

I realize there is concern about the agriculture land value increases experienced over the past several years. But recent market activity suggests that land values have moderated, most notably in those areas that experienced the greatest increases in recent years such as the Midwest. Although lower commodity prices and increases in interest rates could put downward pressure on the value of farmland, Farmer Mac does not expect a repeat of the 1980s when agricultural land values collapsed. Fortunately, we see what others in the rural lending industry have observed, that farmers and ranchers simply are not taking on as much debt as they had in the past.

In summation, Farmer Mac continues to provide a stable source of liquidity, capital and risk management tools to help rural lenders meet the financing needs to their customers. With a diverse array of lending products and sources of capital, Farmer Mac is well positioned to provide rural America with the sophisticated and low-cost products and services demanded by today's rural borrowers.

Thank you, and I would be happy to answer any questions you may have.

[The prepared statement of Mr. Buzby follows:]

Prepared Statement of Timothy L. Buzby, President and Chief Executive Officer, Federal Agricultural Mortgage Corporation (Farmer Mac), Washington, D.C.

Introduction

Chairman Crawford, Ranking Member Costa, and distinguished Members of the Subcommittee, thank you for your invitation to appear today to testify on behalf of the Federal Agricultural Mortgage Corporation, which is commonly known as Farmer Mac. My name is Tim Buzby, and I am the President and Chief Executive Officer of Farmer Mac. I appreciate the opportunity to appear before your Subcommittee today to provide you with some insight into what we at Farmer Mac see taking place in the rural credit financing markets.

Farmer Mac is a stockholder-owned, federally chartered corporation that combines private capital and public sponsorship to serve a public purpose. The company was established under Federal legislation first enacted in 1988 and amended most recently in 2008. Congress has charged Farmer Mac with the mission of providing a secondary market for a variety of loans made to borrowers in rural America, including mortgage loans secured by agricultural real estate, rural utility loans, and certain loans guaranteed by the U.S. Department of Agriculture (USDA). This sec-

ondary market increases the availability of long-term credit at stable interest rates to America's rural communities, including farmers, ranchers, other rural residents and businesses, and rural utility cooperatives, and provides those borrowers with the benefits of capital markets pricing and product innovation. In Farmer Mac's role as the secondary market for rural America, we work closely with all types and sizes of rural lenders, including commercial and community banks, Farm Credit System institutions, insurance companies, credit unions, and lenders to rural electric cooperatives. We also deal directly with other financial counterparties as we serve as a bridge between the national capital markets and the rural credit markets by attracting new capital for financing rural borrowers. Farmer Mac's position at the intersection of Main Street, where the lending industry and borrower community come together in rural America, and Wall Street allows us to provide a unique perspective about the environment for rural credit.

Farmer Mac exists to deliver capital and liquidity to rural America and offers a variety of effective financing options and products tailored to the needs of its rural lender customers that increase the ability of those lenders to offer low-cost funding to their rural borrower customers. Although we work directly with rural lenders, ultimately the greatest benefit we are able to provide is to your constituents—America's farmers, ranchers, rural utility cooperatives, and business owners in rural communities. Farmer Mac's current book of business includes loans originated by approximately 900 different financial institutions across the nation. By working with such a vast network of rural lenders, we introduce more competition into the marketplace and ensure that your rural constituents are receiving the lowest interest rates and most favorable terms possible for their financing needs. In fact, the interest rates available to borrowers through the products offered by Farmer Mac are some of the most competitive in the market today. However, whether or not a rural borrower ultimately chooses a Farmer Mac loan product, Farmer Mac's participation in the rural lending arena provides that borrower with the opportunity to obtain a low interest rate on terms that work for that individual. That is good for rural borrowers, their families, their communities, and rural America in general. Since its creation in 1988, Farmer Mac has helped to fund loans to over 60,000 borrowers in all 50 states, resulting in nearly $35 billion of investment in rural America.

Current Conditions

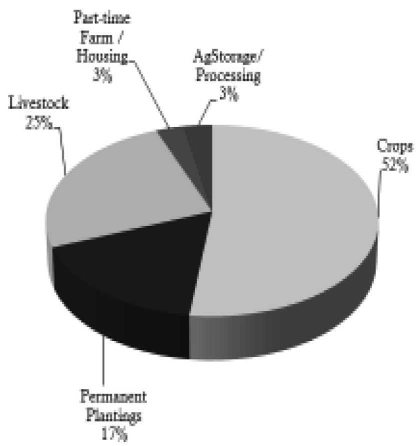
The agricultural economy has been robust for several years, driven by increased demand for food both in the United States and around the world as well as efficiencies in farming production, among other factors. This has not gone unnoticed in the capital markets, as investors have looked to Farmer Mac as a vehicle to invest in rural America. These investors are attracted to the fact that today's agricultural producers are more efficient and productive than ever, more sophisticated in their financing arrangements, and are providing the marketplace with quality commodities at competitive prices. One indication of this interest in investing in rural America is the regular demand for Farmer Mac's debt and equity securities. As an example, Farmer Mac has seen great demand in its auction of over $250 million of term debt over the past 3 months. These debt offerings have attracted competitive bids from multiple financial institutions, driving Farmer Mac's cost of funds down by an average of 10 basis points per offering. Lower cost funding for Farmer Mac directly benefits farmers, ranchers, and rural utility cooperatives in the form of lower interest rates on products financed by Farmer Mac.

The credit quality of Farmer Mac's portfolio remains a great story. We are extremely proud of our credit quality, and it will continue to be the cornerstone of our success in the future. As of March 31, 2014, Farmer Mac's overall 90 day delinquency rate on the loans in its $14.1 billion portfolio was near historical lows at only 0.21%. Through the end of first quarter 2014, Farmer Mac has never experienced any credit losses in its Rural Utilities, USDA Guarantees, and Institutional Credit lines of business and has experienced cumulative losses of only $31 million in its Farm & Ranch line of business during Farmer Mac's entire 26 year history on $19.2 billion of cumulative originations (0.16%). Although Farmer Mac's talented underwriting staff can take much of the credit for the credit quality in Farmer Mac's portfolio, growing conditions, commodity prices, and agriculture exports from across the nation have been very good over the past 10 years and have contributed to growth in U.S. agriculture production and, consequently, borrower repayment capacity. Nonetheless, Farmer Mac understands that agriculture is cyclical, with many diverse industries that respond in different ways to changes in economic conditions. Those individual industries often are affected differently, sometimes positively and sometimes negatively, by prevailing domestic and global economic factors and regional weather conditions. This results in cycles where one or more industries may be under stress at the same time that others are not.

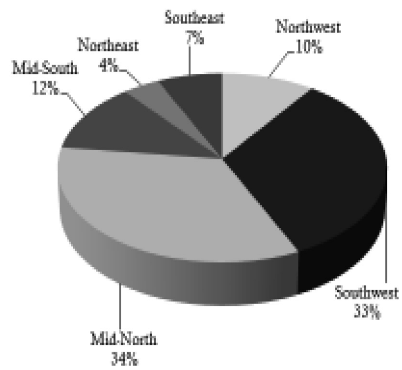
Our policy at Farmer Mac is to diversify our Farm & Ranch portfolio both geographically and by agricultural commodity. We direct our marketing efforts toward agricultural lenders throughout the nation to achieve commodity and geographic diversification in our exposure to credit risk. Farmer Mac's Farm & Ranch portfolio remains diverse both geographically and by agricultural commodity, as illustrated in the two charts below that are current as of March 31, 2014. We take pride in the diversified nature of our loan portfolio that ranges from almond groves in California to wheat, corn, and soybean crops in the Midwest and from cattle ranches in the Southwest to electrical distribution cooperatives in the Southeast. We have found over the years that this diversification serves us well as the inevitable cycles of weather and commodity prices impact profits in agricultural industries or geographies because as certain portfolio segments are stressed, others can benefit. Farmer Mac's overall portfolio also benefits from the diversification added by its lines of business other than Farm & Ranch, including USDA Guarantees, Rural Utilities, and Institutional Credit. We continue to closely monitor sector profitability, economic conditions, and agricultural land value and geographic trends to tailor underwriting practices to changing conditions as part of our robust underwriting process.

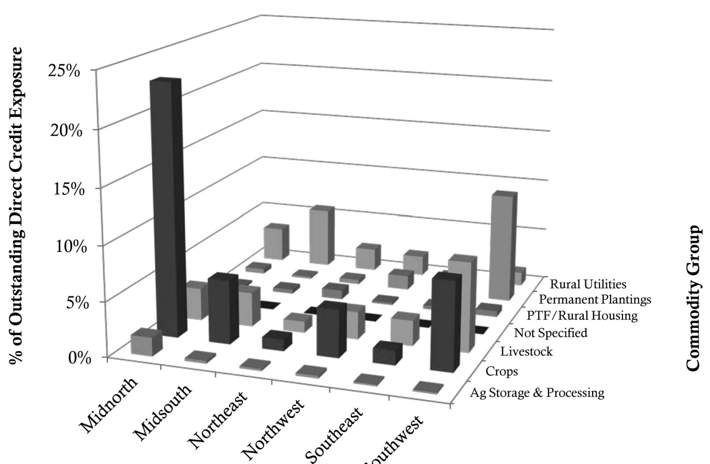
March 31, 2014

Commodity Type



Geography





Although farm incomes are projected to decrease in 2014 compared to 2013 primarily because of lower cash grain prices, farm incomes are still very high from a

historical perspective and above the 10 year average. In Farmer Mac's experience, farmers and ranchers generally have stronger balance sheets compared to several years ago, with high working capital and low leverage. There is great competition in the agricultural lending space, particularly for the most successful producers who have become more sophisticated in their borrowing and take advantage of lender competition to obtain low rates and favorable terms. More and more, these borrowers are choosing mortgage loan products with long-term fixed rates to lock in low and known interest costs. Another trend that Farmer Mac has observed is that the primary use of funds for many new loans is to refinance existing debt rather than to purchase new real estate.

Agricultural land values have increased over the past several years, but recent market activity suggests that land values may have moderated, most notably in those areas that have experienced the greatest increase, such as the Midwestern region. While the increase in land values has varied by geographic region, it appears to have been spurred by a combination of factors, including strong demand for agricultural products and resulting high commodity prices, particularly for corn, soybeans, and wheat, as well as good yields, low interest rates, and landowners choosing to reinvest their profits in the acquisition of more land. Lower commodity prices and increases in interest rates could put downward pressure on the values of farmland, although Farmer Mac does not expect a repeat of the 1980s when agricultural land values collapsed. Some of the reasons for this belief are that debt loads are lighter today, the interest rate environment is much more transparent than in the 1970s and 1980s, world markets are more transparent and interconnected today, and the current run-up in land values is lower and more gradual than the increase in land values in the 1970s. We see what others in the rural lending industry have observed—that farmers and ranchers simply are not taking on as much debt as they have in the past. The general increase in land values has resulted in less acreage encumbered as collateral, as much of the financing being done today is with cash or a mix of cash, free and clear collateral, and debt. It appears that farmers and ranchers have learned from the mistakes of the past and are not buying land at inflated prices with debt, and lenders are also more disciplined than in the 1980s.

Farmer Mac has been diligent in monitoring land values and has instituted measures to ensure that its Farm & Ranch portfolio remains sound. For example, last year we adopted stricter loan-to-value ratio (LTV) requirements for loans located in the Corn Belt in the Midwestern states where land prices have seen the highest escalation in recent years. Even before this change, the LTVs of loans in Farmer Mac's Farm & Ranch portfolio have historically been very low. The weighted average original LTV (based on original appraised value that has not been indexed to provide a current market value or reflect amortization of loans) for the loans in Farmer Mac's Farm & Ranch portfolio was approximately 48% as of March 31, 2014. The weighted average current LTV (based on original appraised value but which reflects loan amortization since purchase) for Farmer Mac's Farm & Ranch loans was approximately 41% as of March 31, 2014. The average LTV of Farmer Mac's Farm & Ranch loans decreases even more if the values in the original appraisals are indexed to current land values.

Like others with a strong interest in agriculture, Farmer Mac continuously monitors significant weather events throughout the country and has been paying close attention to the current drought conditions in the western part of the United States, including California. The water level in many California reservoirs is only half of their average year-to-date water storage levels, and the snowpack in the higher elevations whose runoff would typically replenish low reservoir levels is at a third or less than normal levels. Though many farm irrigation districts will receive little or no water from the governing water authorities, the impact on individual farmers will vary due to alternative water sources the farmer may have in place. Farmer Mac has not observed any material effect on its portfolio due to these drought conditions as of March 31, 2014, but any continuation of extreme or exceptional drought conditions beyond the 2014 water year could have adverse future effects. This is particularly true in the permanent plantings sector, where the value of the related collateral is closely tied to the production value and capability of the permanent plantings, and in the dairy sector, which may experience increased feed costs as water is diverted away from hay acreage commonly relied upon by dairy producers and toward land supporting other agricultural commodities.

In addition to Farmer Mac's secondary market activities in its Farm & Ranch line of business that involves mortgage loans secured by first liens on agricultural real estate, Farmer Mac has also been an active participant in the secondary market for loans guaranteed by the USDA under the Consolidated Farm and Rural Development Act (the CONACT) since 1991 after Congress granted that authority to Farmer Mac. In that time, Farmer Mac has provided lenders and their customers with

liquidity and competitive rates, including longer-term fixed rates, on loans guaranteed by the USDA under the CONACT that are eligible for Farmer Mac to purchase.

With regard to Farmer Mac's Rural Utilities line of business, the demands of that industry for capital and financing have historically tended to be linked to the state of the general economy and applicable environmental regulations. Continued weakness in the general economy in the United States has reduced the demand for rural electric power and, consequently, the need for rural utilities cooperatives to expand in recent years. This lower demand within the industry has increased competition for Farmer Mac's customer base from other lenders. Domestic economic indicators continue to show modest growth, and Farmer Mac and industry sources expect that demand for rural utilities loans will increase as the economy eventually strengthens. Farmer Mac believes that the rural utilities industry will have significant needs for financing over the course of the next decade, as capital will be needed for growth and modernization, including generation and transmission (G&T) and distribution system improvements and demand-side management. In addition, the industry will also require capital to comply with any future public policy initiatives such as environmental regulations and clean energy initiatives. Farmer Mac stands ready to work with the lenders to help meet the needs of their rural electric cooperative borrowers. Since the inception of the Rural Utilities line of business in 2008, Farmer Mac's secondary market activities have helped nearly 170 rural electric cooperatives throughout the United States obtain financing to serve approximately 4.6 million customers in rural areas.

Conclusion

Farmer Mac continues to provide a stable source of liquidity, capital, and risk management tools to help rural lenders meet the financing needs of their customers. With a diverse array of lending products and capital sources, Farmer Mac is well positioned to provide rural America with the sophisticated and low cost lending products demanded by today's rural borrowers. Last year marked Farmer Mac's 25th anniversary of serving rural America, and we at Farmer Mac are more energized than ever to continue to deliver the benefits envisioned by Congress at Farmer Mac's creation—greater access to affordable credit and a wide variety of loan products for rural communities. As I reflect on my nearly 14 year tenure at Farmer Mac, I am proud to say that the addition of Farmer Mac to the rural financing arena has fulfilled Congress's vision. Farmer Mac is a valuable and much relied upon asset for rural America, as lenders seek to offer their customers long-term interest rates at low levels, fund larger real estate loans, and manage borrower exposure levels. We are proud to partner with America's agricultural bankers, Farm Credit System institutions, and rural electric cooperatives to serve rural communities, and we remain steadfast in our commitment to meet their needs. Farmer Mac is committed to fulfilling its mission of delivering capital and increasing lender competition for the benefit of rural communities throughout the nation. Rest assured that we are prepared to build on our recent positive results and will continue to innovate, collaborate, and provide unparalleled service with a renewed focus on the stewardship of our public mission as we help build a strong and vital rural America.

Thank you for the opportunity you have generously provided Farmer Mac to give testimony on current credit conditions in rural America. We look forward to working with Members of Congress and our business partners to do even more to fulfill our mission. I would be happy to answer any questions you may have.

Background Information About Farmer Mac

Farmer Mac currently employs just over 70 people who are located primarily at offices in Washington, D.C. and in Johnston, Iowa. Farmer Mac accomplishes its Congressional mission of providing liquidity and lending capacity to rural lenders by:

- purchasing eligible loans directly from lenders;
- providing advances against eligible loans by purchasing obligations secured by those loans;
- securitizing assets and guaranteeing the payment of principal and interest on the resulting securities that represent interests in, or obligations secured by, pools of eligible loans; and
- issuing long-term standby purchase commitments ("standby commitments") for eligible loans.

Farmer Mac's activities are intended to provide lenders with an efficient and competitive secondary market that enhances these lenders' ability to offer competitively-priced financing to rural borrowers. This secondary market is designed to increase the availability of long-term credit at stable interest rates to America's rural com-

munities and to provide rural borrowers with the benefits of capital markets pricing and product innovation. Farmer Mac's activities are subject to oversight by Congress as well as a dedicated safety and soundness Federal regulator (the Office of Secondary Market Oversight within the Farm Credit Administration) and the U.S. Securities and Exchange Commission.

Farmer Mac's purchases of both eligible loans and obligations secured by eligible loans, as well as Farmer Mac's guaranteed securities sold to third party investors, increase lenders' liquidity and lending capacity and provide a continuous source of funding for lenders that extend credit to borrowers in rural America. Farmer Mac's standby commitments for eligible loans held by lenders, as well as Farmer Mac's guaranteed securities retained by lenders in exchange for the related securitized loans, result in lower regulatory capital requirements for the lenders and reduced borrower or commodity concentration exposure for some lenders, thereby expanding their lending capacity. By increasing the efficiency and competitiveness of rural finance, the secondary market provided by Farmer Mac has the potential to lower the interest rates paid on loans by rural borrowers.

Farmer Mac conducts its secondary market activities through four lines of business—Farm & Ranch, USDA Guarantees, Rural Utilities, and Institutional Credit. The loans eligible for the secondary market provided by Farmer Mac include:

- mortgage loans secured by first liens on agricultural real estate, including part-time farms and rural housing (encompassing the Farm & Ranch line of business);
- agricultural and rural development loans guaranteed by the United States Department of Agriculture (USDA) (encompassing the USDA Guarantees line of business); and
- loans made by cooperative lenders to finance electrification and telecommunications systems in rural areas (encompassing the Rural Utilities line of business).

Farmer Mac also purchases and guarantees general obligations of rural lenders that are secured by pools of the types of eligible loans described above (encompassing the Institutional Credit line of business). As of March 31, 2014, the total outstanding amount of the eligible loans included in all of Farmer Mac's lines of business was $14.1 billion.

Under the Farm & Ranch line of business, Farmer Mac purchases or commits to purchase eligible mortgage loans secured by first liens on agricultural real estate and rural housing. Farmer Mac also guarantees securities representing interests in pools of mortgage loans eligible for the Farm & Ranch line of business. Loans must meet credit underwriting, collateral valuation, documentation and other standards specified by Farmer Mac. As of March 31, 2014, the average unpaid loan balance for loans outstanding in the Farm & Ranch line of business was $449,000, and the majority of loans were to small farms (less than $350,000 in gross farm income) and family farmers (majority owned and operated by a family). At the end of 2013, Farmer Mac had 669 approved lenders eligible to participate in Farmer Mac's Farm & Ranch line of business. In addition to participating directly in the Farm & Ranch line of business, some of the approved lenders facilitate indirect participation by other lenders by managing correspondent networks of lenders from which the approved lenders purchase loans to sell to Farmer Mac.

Under the USDA Guarantees line of business, Farmer Mac's wholly-owned subsidiary purchases the portions of certain agricultural, rural development, business and industry, and community facilities loans guaranteed by the USDA under the Consolidated Farm and Rural Development Act (CONACT). Any lender authorized by the USDA to obtain a USDA guarantee on a loan under the CONACT may participate in Farmer Mac's USDA Guarantees line of business. During 2013, 195 lenders, consisting mostly of community and regional banks, sold USDA-guaranteed portions of loans to Farmer Mac. As of March 31, 2014, the aggregate outstanding principal balance of assets in the USDA Guarantees line of business was $1.7 billion.

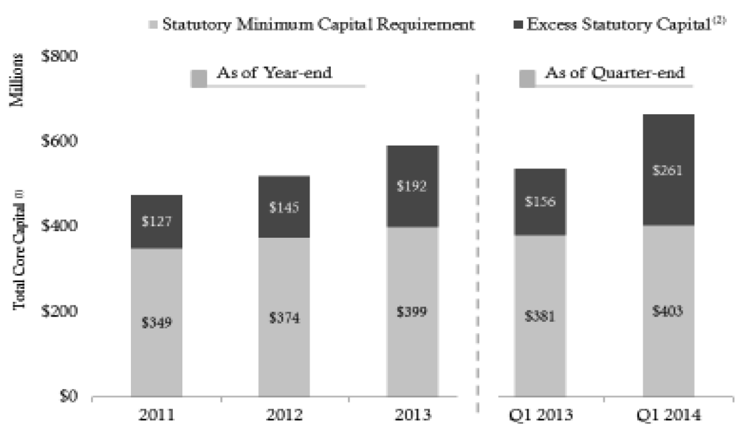
Farmer Mac initiated the Rural Utilities line of business after Congress expanded Farmer Mac's authorized secondary market activities to include rural utility loans in the Farm Bill of 2008. Farmer Mac's authorized activities under this line of business are similar to those conducted under the Farm & Ranch line of business—purchases of, and guarantees of securities backed by, eligible rural utilities loans for the financing of electrification and telecommunications systems in rural areas. To be eligible, loans must meet Farmer Mac's credit underwriting and other specified standards. As of March 31, 2014, the aggregate outstanding principal balance of rural utilities loans held by Farmer Mac was $1.0 billion.

Under the Institutional Credit line of business, Farmer Mac purchases or guarantees general obligations of rural lenders that are secured by pools of loans that would be eligible for purchase under one of Farmer Mac's other lines of business. Farmer Mac refers to these obligations as AgVantage® securities. Farmer Mac guarantees AgVantage® securities as to the timely payment of principal and interest and may retain AgVantage® securities in its portfolio or sell them to third parties in the capital markets. Farmer Mac's purchase and guarantee of AgVantage® securities provide a continuous source of funding for lenders that extend credit to borrowers in rural America. As of March 31, 2014, outstanding securities held or guaranteed by Farmer Mac in its Institutional Credit line of business totaled $6.1 billion.

After buying eligible loans, Farmer Mac can either retain them for investment or pool the loans together, securitize them, and guarantee the timely payment of interest and principal on the resulting securities. Securities that Farmer Mac guarantees are sold to investors in the capital markets, exchanged for the loans and retained by the lender, or held by Farmer Mac.

Farmer Mac's charter establishes three capital standards for Farmer Mac—minimum capital, critical capital, and risk-based capital. Farmer Mac is required to comply with the higher of the minimum capital requirement and the risk-based capital requirement. Also, in accordance with a recently effective FCA regulation on capital planning, Farmer Mac's board of directors has adopted a policy for maintaining a sufficient level of Tier 1 capital and imposing restrictions on dividends and bonus payments in the event that Farmer Mac's Tier 1 capital falls below specified thresholds. As illustrated in the chart below that is current as of March 31, 2014, Farmer Mac has continually improved its capital position over the past several years through a combination of retained earnings and equity offerings. Farmer Mac also just completed a $75 million preferred stock offering last week to further enhance its capital position.

Key Company Metrics—Capital



(1) Core Capital defined as total Equity less Accumulated Other Comprehensive Income

(2) Excess Statutory Capital defined as Core Capital less Statutory Minimum Capital Requirement

Additional information about Farmer Mac is available on Farmer Mac's website at *www.farmermac.com.*

The CHAIRMAN. Thank you. I appreciate that. I now recognize the President and CEO, United Bank and Trust of Marysville, Kansas, on behalf of the American Bankers Association, Mr. Leonard Wolfe. You are recognized for 5 minutes.

STATEMENT OF LEONARD WOLFE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, UNITED BANK & TRUST, MARYSVILLE, KS; ON BEHALF OF AMERICAN BANKERS ASSOCIATION

Mr. WOLFE. Chairman Crawford, and Members of the Subcommittee, my name is Leonard Wolfe, and I am the President of United Bank & Trust in Marysville, Kansas. We are the largest commercial agricultural lender in Kansas, second only to the Farm Credit System. I am also currently serving as the Chairman of the Kansas Bankers Association, and I serve as Vice Chairman of the American Bankers Association Agricultural Credit Taskforce. I appreciate the opportunity to present the views of the ABA on credit conditions and credit availability in rural America.

The topic of today's hearing is very timely. The agriculture economy has been performing extremely well. Farm and ranch incomes for the past 5 years have been some of the best in history. With the new farm bill in place, farmers, ranchers and their bankers have certainty from Washington about future agricultural policy. Interest rates continue to be at or near record lows. And the banking industry has the people, capital and liquidity to help American farmers sustain this excellent agricultural economy.

Banks continue to be the first place that farmers and ranchers turn when looking for agricultural loans. In fact, more farmers and ranchers receive credit from the banking industry than from any other source today. In 2013, farm banks, which the ABA defines *as any bank with more than 14 percent of their loans made to farmers or ranchers,* increased agricultural lending nine percent to meet these rising credit needs, and now provide nearly $90 billion in total farm loans. Farm banks are an essential resource for small farmers, holding $45 billion in small farm loans and $12 billion in micro-small farm loans. These farm banks are healthy, well capitalized and stand ready to meet the credit demands of our nation's farmers, large and small.

I would like to thank Congress and especially the Agriculture Committees for repealing borrower term limits on USDA Farm Service Agency guaranteed loans. Banks work closely with the USDA to make additional credit available by utilizing the Guaranteed Farm Loan Programs. The repeal of borrower limits on USDA's Farm Service Agency guaranteed loans has allowed farmers to continue to access credit from banks like mine as they grow, ensuring credit access for farmers across the country.

We remain concerned with certain areas of the agriculture credit market. In particular, we believe that the Farm Credit System, a government sponsored entity, has veered away from its intended mission and now represents an unwarranted risk to taxpayers. The Farm Credit System was founded in 1916 to ensure that young, beginning and small farmers and ranchers had access to credit. It has since grown into a $261 billion behemoth. To put this into perspective, if the Farm Credit System were a bank, it would be the ninth

largest bank in the United States, and larger than 99.9 percent of banks in the country.

This System operates as a government sponsored entity, and represents a risk to taxpayers the same way that Fannie Mae and Freddie Mac do. The Farm Credit System benefits from significant tax breaks valued at $1.3 billion in 2013, giving it a significant edge over private sector competitors. Moreover, the Farm Credit System enjoys government backing formalized by the creation of a $10 billion line of credit with the U.S. Treasury in 2013.

The Farm Credit System has moved significantly from its charter to serve young, beginning and small farmers, and now primarily serves large established farms who could easily obtain credit from the private sector. In fact, the majority of Farm Credit System loans outstanding are in excess of $1 million. Any farmer able to take in over $1 million in debt is not a small farmer. Moreover, small borrowers accounted for less than 16 percent of all new Farm Credit System loans in 2013.

Our nation's farmers and ranchers are a critical resource to our economy. Ensuring that they continue to have access to adequate credit is essential for the wellbeing of our whole nation. America's banks remain well equipped to serve the borrowing needs of farmers of all sizes. An important step in ensuring credit availability is to review entities such as the Farm Credit System and ensure that they stick to their charter of helping young, beginning and small farmers.

Thank you. I would be happy to answer any questions you may have.

[The prepared statement of Mr. Wolfe follows:]

PREPARED STATEMENT OF LEONARD WOLFE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, UNITED BANK & TRUST, MARYSVILLE, KS; ON BEHALF OF AMERICAN BANKERS ASSOCIATION

Chairman Crawford, Ranking Member Costa, and Members of the Subcommittee, my name is Leonard Wolfe, and I am the President, CEO and Chairman of the Board of United Bank & Trust in Marysville, Kansas. United Bank is a $570 million bank with fifteen branches serving Marshall, Nemaha, Brown, Clay, Washington, Cloud, and Riley counties in Kansas. We have over $176 million in agricultural real estate and production loans in our portfolio—nearly ½ of all of our loans are to farmers and ranchers. In addition, we finance businesses that support, in some way, the needs of farmers and ranchers in our part of the state.

I am also the Chairman of the Kansas Bankers Association and I serve as Vice Chairman of the American Bankers Association's Agricultural Credit Task Force. I appreciate the opportunity to present the views of the ABA on credit conditions and credit availability in rural America.

The American Bankers Association is the voice of the nation's $14 trillion banking industry, which is composed of small, regional and large banks that together employ more than two million people, safeguard $11 trillion in deposits and extend nearly $8 trillion in loans. ABA is uniquely qualified to comment on agricultural credit issues as banks have provided credit to agriculture since the founding of our country. Over 5,470 banks—nearly 81% of all banks—reported agricultural loans on their books at year end 2013 with a total outstanding portfolio of over $149 billion.

The topic of today's hearing is very timely. The agricultural economy has been performing extremely well. Farm and ranch incomes for the past 5 years have been some of the best in history. With the new farm bill in place, farmers, ranchers, and their bankers have certainty from Washington about future agricultural policy. Interest rates continue to be at or near record lows, and the banking industry has the people, capital, and liquidity to help American farmers and ranchers sustain this excellent agricultural economy.

Banks continue to be the first place that farmers and ranchers turn when looking for agricultural loans. In fact, more farmers and ranchers receive credit from the

banking industry than from any other source. Our agricultural credit portfolio is very diverse—we finance large and small farms, urban farmers, beginning farmers, women farmers, and minority farmers. To bankers, agricultural lending is good business and we make credit available to all who can demonstrate they have a sound business plan, the experience, and the ability to repay.

In 2013, farm banks—banks with more than 14% of their loans made to farmers or ranchers—increased agricultural lending 9.1 percent to meet these rising credit needs, and now provide nearly $90 billion in total farm loans. Farm banks are an essential resource for small farmers, holding $45 billion in small farm loans, and $12 billion in micro-small farm loans. These farm banks are healthy and well capitalized and stand ready to meet the credit demands of our nation's farmers large and small.

In addition to our commitment to farmers and ranchers, thousands of farm dependent businesses—food processors, retailers, transportation companies, storage facilities, manufacturers, *etc.*—receive financing from the banking industry as well. Agriculture is a vital industry to our country, and financing it is an essential business for many banks, mine included.

Banks work closely with the USDA's Farm Service Agency to make additional credit available by utilizing the Guaranteed Farm Loan Programs. The repeal of borrower limits on USDA's Farm Service Agency guaranteed loans has allowed farmers to continue to access credit from banks like mine as they grow, ensuring credit access for farmers across the country.

We remain concerned with certain areas of the agricultural credit market. In particular, we are worried that the Farm Credit System—a government sponsored entity—has veered away from its intended mission and now represents an unwarranted risk to taxpayers. The Farm Credit System was founded in 1916 to ensure that young, beginning, and small farmers and ranchers had access to credit. It has since grown into a $261 billion behemoth offering complex financial services. To put this in perspective, ***if the Farm Credit System were a bank it would be the ninth largest in the United States, and larger than 99.9% of the banks in the country.***

This System operates as a government sponsored entity and represents a risk to taxpayers in the same way that Fannie Mae and Freddie Mac do. It benefits from significant tax breaks—valued at $1.3 billion in 2013—giving it a significant edge over private sector competitors. Moreover, the Farm Credit System enjoys a government backing, formalized by the creation of a $10 billion line of credit with the U.S. Treasury in 2013.

The Farm Credit System has veered significantly from its charter to serve young, beginning, and small farmers and ranchers, and now primarily serves large established farms, who could easily obtain credit from the private sector. In fact, the majority of Farm Credit System loans outstanding are in excess of $1 million. Any farmer able to take on over $1 million in debt is not a small farmer. Moreover, small borrowers accounted for less than 16% of all new Farm Credit System Loans in 2013.

Our nation's farmers and ranchers are a critical resource to our economy. Ensuring that they continue to have access to adequate credit to thrive is essential for the wellbeing of our whole nation. America's banks remain well equipped to serve the borrowing needs of farmers of all sizes. An important step in ensuring credit availability is to review entities such as the Farm Credit System and ensure that they stick to their charter of helping young, beginning and small farmers.

In my testimony today I would like to elaborate on the following points:

➢ Banks are the primary source of credit to farmers and ranchers in the United States;

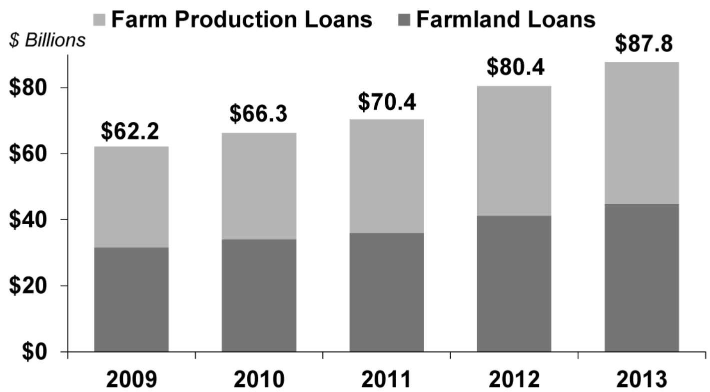
➢ Banks work closely with the USDA to make additional credit available via the Guaranteed Farm Loan Program; and

➢ The Farm Credit System has become too large and unfocused, using taxpayer dollars to subsidize large borrowers.

I. Banks Are the Primary Source of Credit to Farmers and Ranchers in the United States

For my bank and for many of our members, agricultural lending is a significant component of their business activities. ABA has studied and reported on the performance of "farm banks" for decades and, we are pleased to report that the performance of these highly specialized agricultural lending banks continues to be strong. ABA defines a farm bank as one with more than fourteen percent farm or ranch loans (to all loans).

Farm Banks Exhibit Solid Farm Lending Growth



Source: Federal Deposit Insurance Corporation.

At the end of 2013, there were 2,152 banks that met this definition. Farm lending posted solid growth during 2013. Total farm loans at farm banks increased by 9.1 percent to $87.8 billion in 2013 up from $80.4 billion in 2012. Approximately $1 in every $3 lent by a farm bank is an agricultural loan.

Farm production loans grew at a faster rate than farm real estate loans. Outstanding farm production loans grew at a pace of 9.7 percent, or $3.8 billion, to a total of $43.0 billion. Farmland loans rose by 8.6 percent, or $3.5 billion, to $44.7 billion.

Farm banks are a major source of credit to small farmers—holding approximately $45.2 billion in small farm loans (less than $500,000) with $11.5 billion in micro-small farm loans (less than $100,000) at the end of 2013. The number of outstanding small farm loans at farm banks totaled 778,545 with the vast majority—over 513,000 loans—under $100,000.

One area of concern for farm bankers and their customers has been the rapid appreciation in farmland values in some areas of the country. The run up in farmland values so far has not been a credit driven event. Farm banks are actively managing the risks associated with agricultural lending and underwriting standards on farm real estate loans are very conservative. The key consideration in underwriting any loan is the ability of the customer to repay regardless of the collateral position in the loan. To further manage risk, we regularly stress test our loan portfolios to judge repayment capacity under different scenarios.

After several years of large increases in farmland values, the consensus view among bankers I know is that the increase in cropland values has slowed. USDA estimates of lower commodity prices in 2014 seem to have cooled off the demand for farm real estate somewhat. We watch the farm real estate market very closely, as do my customers. Eighty-two percent of farmer and rancher wealth is tied up in their real estate.

II. Banks Work Closely With the USDA's Farm Service Agency to Make Additional Credit Available by Utilizing the Guaranteed Farm Loan Programs

I would like to thank Congress, especially the Agricultural Committees, for repealing borrower term limits on USDA Farm Service Agency guaranteed loans. Term limits restricted farmer access to capital, and with the expansion of the farm economy over the past 10 years, there are some farmers who are not able to obtain credit from banks like mine without a guaranty from USDA. The USDA's Farm Service Agency guaranteed loan program has been a remarkable success. Today, nearly $12 billion in farm and ranch loans are made by private sector lenders like my bank and are guaranteed by the USDA. There are nearly 43,000 loans outstanding—of course some farmers have more than one guaranteed loan, so this number is not to be confused with the number of individual farmers and ranchers, but the numbers of individuals accessing credit under this program is very significant.

This program has grown over the past 5 years, with less than $9 billion outstanding at the close of FY08 to nearly $12 billion today. The loans made by banks like mine under this program are modest in size. The average outstanding guaranteed real estate loan is $439,000 and the average outstanding guaranteed non real

estate secured loan is $250,000. Clearly, we are reaching customers who have modest-sized operations, who are in the process of starting their farm or ranch operation, or who are recovering from some sort of financial set-back. Despite the fact that these customers do not have either the earnings or collateral to qualify for conventional credit, losses in the program have been extremely small. Over the last 5 fiscal years losses have ranged from a high of 0.6% in FY10 to a low of 0.3% in FY13. These are extremely low losses—especially for customers who are perceived to be a higher risk than other customers, hence the need for the USDA credit enhancement. Bankers who utilize the guaranteed farm loan programs offered by USDA know what they are doing and work very closely with their farm and ranch customers to properly service these loans. The Farm Service Agency deserves a great deal of credit for administering such a successful public/private partnership. We urge you to continue to support this very worthwhile program.

III. The Farm Credit System is a Large Government Sponsored Entity That Primarily Serves Large Borrowers at the Expense of Taxpayers

I mentioned earlier in my testimony that the market for agricultural credit is very competitive. I compete with several other banks in my service area, finance companies from all of the major farm equipment manufacturers, several international banks, credit unions, life insurance companies, and finance companies owned by seed and other supply companies to name a few. The most troublesome competitor I face is the taxpayer-backed and tax-advantaged Federal Farm Credit System (FCS). The FCS was chartered by Congress in 1916 as a borrower-owned cooperative farm lender at a time when banks did not have the legal authority to make long-term farm real estate loans. Over the ensuing 98 years the FCS has received numerous charter enhancements, and has ventured into areas that are not appropriate for a farmer-owned farm lending business.

Today ***the FCS is a large and complex financial services business with $261 billion in assets.*** If it were a bank, it would be the ninth largest bank in the United States. It is tax-advantaged and enjoyed a combined local, state, and Federal tax rate in 2013 of only 4.5%. According to the Federal Farm Credit Banks Funding Corporation, ***the tax advantages enjoyed by the FCS in 2013 were worth $1.348 billion*** or 29% of the Farm Credit System's net income in 2013.[1]

The Farm Credit System is a Government Sponsored Entity

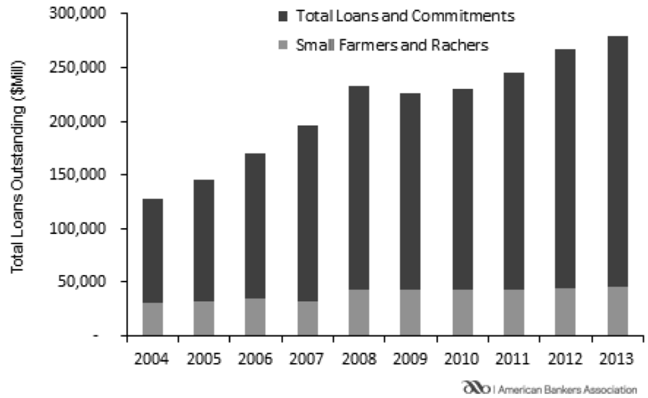
In spite of their size, profitability, and tax advantages the Farm Credit System presents the same kind of potential threat to the American taxpayer as Fannie Mae and Freddie Mac. As a Government Sponsored Enterprise (GSE) like Fannie Mae and Freddie Mac, the American taxpayer is the ultimate back stop should the Farm Credit System develop financial problems. This reality was formalized in 2013 when the Farm Credit System Insurance Corporation arranged a $10 billion line of credit "with the Federal Financing Bank, a Federal instrumentality subject to the supervision and direction of the U.S. Treasury—to which the Federal Financing Bank would advance funds to the [Farm Credit System] Insurance Corporation. Under its existing statutory authority, the [Farm Credit System] Insurance Corporation will use these funds to provide assistance to the System Banks in exigent market circumstances which threaten the Banks' ability to pay maturing debt obligations. The agreement provides for advances of up to $10 billion and terminates on September 30, 2014, unless otherwise extended."[2]

We believe the farmers who own stock of the Farm Credit System—and the American taxpayers who back it—deserve a better understanding of what transpired between the Farm Credit System and the U.S. Treasury last September, but very little information is available to the public. Unlike the housing GSEs which are subject to reform efforts to lessen the taxpayer's exposure, the Farm Credit System seems to be increasing its dependence upon the U.S. Treasury.

[1] Federal Farm Credit Banks Funding Corporation; *2013 Annual Information Statement of the Farm Credit System;* February 28, 2014. Page F–52.

[2] Federal Farm Credit Banks Funding Corporation; *2013 Annual Information Statement of the Farm Credit System;* February 28, 2014, page 23.

FCS Loans Going to Large Borrowers



Source: FCA's Annual Report of the Farm Credit System's Young, Beginning and Small Farmer Mission Performance.

Congress created the Farm Credit System as a public option for farm finance when farmers were having trouble getting the credit they needed from non-government sources. The conditions that led to the creation of the Farm Credit System nearly 100 years ago no longer exist, and yet we continue have a government assisted, tax advantaged farm lender providing credit to customers who would be able to easily borrow from taxpaying institutions like mine. In fact, the heavily subsidized credit that FCS lends goes to those who need it least. Despite amendments to the Farm Credit Act of 1980 requiring each FCS lender to have a program for furnishing credit to young, beginning and small farmers and ranchers (YBS), the share of new YBS loans to total new FCS loans continues to ***decline***—even as the assets of the System have expanded enormously. In all categories of YBS lending, new young, beginning, and small farm loans continues to steadily drop with small farm loans declining the most—from a high of 30% of total new loan volume in 2003 to just 15.4% in 2013.[3] Clearly, those who would benefit the most from the highly subsidized credit made available by the FCS are not receiving the benefits that Congress intended them to receive.

Large Borrows Benefit Most from Farm Credit System Subsidy

A review of the 2013 Annual Information Statement from the Federal Farm Credit Banks Funding Corporation indicates that 51.3% of all Farm Credit System outstanding loans at the end of 2013 were in excess of ***$1 million.*** The Farm Credit System does not provide the public with aggregated data by borrower; if they did, we would see a much higher percentage of borrowers with debt in excess of $1 million. In addition, the Farm Credit System does not disclose approved, but unfunded commitments. If it did, the numbers would be even higher. In short, well more than half of the entire Farm Credit System's portfolio at the end of 2013 was to individuals who owed it much more than a million dollars.

We do not believe this is the highest and best use of the Farm Credit System's government sponsorship. Borrowers who can amass over $1 million in credit from the FCS do not need taxpayers to subsidize their debt. Again, small farm borrowers, according to data supplied by the Farm Credit Administration, accounted for less than 16% of all new FCS loans in 2013.

Moreover, the Farm Credit System has wandered dangerously off course into areas of finance that have nothing to do with agriculture, or rural America for that matter. Two recent Farm Credit System loans demonstrate this point:

In 2013, Denver based CoBank, the largest Farm Credit System bank, approved a $750 million loan to Verizon. CoBank's loan was part of a financing package that totaled over $6 billion. Financial institutions from all over the world shared a portion of the loan. CoBank was the only government sponsored enterprise to be a participant in the loan. CoBank's share of the loan was the largest single piece of the credit package. The purpose of the loan was to enable Verizon to purchase the portion of Verizon Wireless that it did not already own. The proceeds of the loan, which

[3] "FCA's Annual Report on the Farm Credit System's Young, Beginning, and Small Farmer Mission Performance: 2013 Results". Office of Regulatory Policy, June 12, 2014 Board Meeting.

closed in 2014, went to London based Vodafone, the corporate entity that owned the rest of Verizon Wireless. The Farm Credit Administration, the regulator of the FCS, has publicly stated that the loan is perfectly legal because Verizon is a "similar-entity" to a rural cooperatively owned telephone company. In other words, since Verizon provides telephone services like a rural telephone cooperative, the loan is a legal for a Farm Credit System lender to make.

On June 2, 2014, CoBank entered into a $350 million "credit agreement" with Connecticut based Frontier Communications Corporation to help finance a $2 billion acquisition by Frontier Communications from AT&T. Frontier Communications is a $16 billion publicly traded company. CoBank played a major role in this financing package in that they are credited with being the "administrative agent and lead arranger" by Frontier. While we have not seen a finding from the Farm Credit Administration about the eligibility of Frontier Communications to borrow from CoBank, we suspect that the regulator will again cite the notion that $16 billion Frontier Communications Corporation is "similar" to a rural cooperatively owned telephone company.

What new benefit has accrued to rural America as a result? These loans facilitated corporate deals designed to maximize shareholder returns. In the case of the Vodafone buyout, U.S. taxpayer supported money was transferred to European investors. As a banker, I understand the concept of maximizing shareholder wealth, but as a taxpayer I have a hard time understanding how the Farm Credit System can be involved in these deals and how the regulator of the Farm Credit System seems to be working to aid and abet their activities.

Conclusion

The banking industry is well positioned to meet the needs of U.S. farmers and ranchers. U.S. agriculture has enjoyed one of the longest periods of financial prosperity in history; financially, American agriculture has never been stronger. USDA projected that at year-end 2013, farm and ranch net worth was nearly $2.7 trillion. This unprecedented high net worth is due in part to a robust increase in farm asset values (mainly farm real estate), but is equally due to solid *earned* net worth as farmers used their excess cash profits to retire debt and to acquire additional equipment and additional land. As a result, farmers and ranchers today have the capacity to tap their equity should there be a decline in farm profitability resulting in diminished cash flows. While no farmer or rancher wants to take on additional debt, the strength of the U.S. farm and ranch balance sheet gives producers options to do so if the need arises.

When the agricultural economy collapsed in the middle 1980s, the banking industry worked closely with farmers and ranchers to restructure their businesses and to rebuild the agricultural economy. Since that time banks have provided the majority of agricultural credit to farmers and ranchers. While other lenders, including the Farm Credit System, shrank their portfolios of agricultural loans or exited the business altogether, banks expanded agricultural lending. Bankers saw opportunity where others did not. Bankers still see great opportunities in agriculture.

Thank you for the opportunity to express the views of the American Bankers Association. I would be happy to answer any questions that you may have.

The CHAIRMAN. Thank you, Mr. Wolfe. I am now pleased to recognize one of my constituents who made the trip up from Arkansas, the President and CEO of The First National Bank of Wynne, Wynne, Arkansas, on behalf of the Independent Community Bankers of America, Mr. Sean Williams. You are recognized for 5 minutes.

STATEMENT OF SEAN H. WILLIAMS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE FIRST NATIONAL BANK OF WYNNE, WYNNE, AR; ON BEHALF OF INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. WILLIAMS. Thank you, Mr. Chairman. I appreciate the invitation to be here today and testify. I am Sean Williams, President and CEO of The First National Bank of Wynne, in Wynne, Arkansas. And I am testifying today at your invitation on behalf of the Independent Community Bankers of America.

Our bank was established in 1915, nearly 100 years ago. And we have branches in five communities, 80 employees and approximately $285 million in assets. Seventy percent of our $150 million loan portfolio serves farmers. The remainder serves businesses that farmers depend on. We are one of the largest ag focused lenders in the State of Arkansas, and serve row crop agriculture, primarily rice, soybeans and corn. But cotton, wheat and milo are also grown in our area. America's 7,000 community banks, primarily in rural areas and in every—nearly every small town in rural America do an outstanding job of providing the credit that farmers and businesses need to be successful in both good times and in bad. Banks under $1 billion in assets extend 50 percent of farm operating loans and 60 percent of farm real estate loans from the banking sector.

Corn and soybean prices are declining. Livestock producers will do better, but drought is of concern. USDA projects net cash and net farm income will be down 22 to 27 percent. We expect about a 15 percent drop locally: 2014 expenses will be the second highest level on record. Federal Reserve district bank surveys project lower income, stable to lower land prices, and higher loan demand and slower repayment rates. Rural credit markets remain highly competitive, and banks have ample liquidity for loan demand and want to make farm loans.

We thank you for passing the new farm bill. Crop insurance funding is extremely important, with 290 million acres insured. We urge Congress not to lower funding or coverage levels. Community bankers and rural communities continue to be hampered by the CFPB's definition of *rural* as it relates to home mortgage lending. We have urged the CFPB to fix the *rural* definition and to better align the QM and escrow rules to eliminate this confusion.

ICBA's Agriculture-Rural America committee, with bankers in every geographical region, recently completed a survey. Credit is plentiful. Farm land prices are stable but could decline if commodity prices remain lower. Drought and weather conditions, problems in many states are concerning. The farm bill and crop insurance are vital to extending credit. Reference prices are adequate but won't always cover production costs. And more farm bill details and decision making tools are needed.

Bankers surveyed are alarmed by the Farm Credit System cherry picking. The FCS leverages tax and funding advantages as a government sponsored enterprise to undercut the loan rates on community banks biggest and financially strongest customers, and ignores less creditworthy borrowers. The Farm Credit Act prohibits undercutting loan rates. Bank's larger, more stable borrowers are important to bank portfolios, allowing lending risks to be spread over both small and large operations. Losing the biggest and the best borrowers elevates risk in our portfolios. This diminishes bank's ability to serve agriculture, lessens credit expertise available to farmers, lessens credit choices for borrowers, and lessens credit availability in rural America.

The regulator, FCA, wants to allow FCS to broadly make non-farm loans. The FCS—when FCS will continue—they won't continue to make farm loans. They want to also now cherry pick the best non-farm loans from bank portfolios, although not authorized by law. FCA's proposed mission related investments regulation

would allow FCS lenders to seek approval for broad non-farm lending programs labeled as investments, loan for manufacturing, apartments, office buildings and hospitals.

The FCA's apparent lack of awareness of CoBank's $725 million Verizon loan is alarming. Verizon and Vodafone are located in New York City and in London. This isn't a rural loan and isn't authorized by the statute. FCA's excuse that this is allowed under the similar-entity provision is not credible as this provision isn't intended to allow enormous non-farm loans for hundreds of millions of dollars in size in non-rural areas in the world's largest cities to non-cooperatives or Fortune 500 corporations. We question the FCA obtaining a $10 billion line of credit at a time of record profits without seeking Congressional approval as recommended in a Brookings Institution Report. Why did the FCA act in secret and behind Congress' back? We strongly recommend a series of hearings reviewing these and other questions. The FCS cherry picks the best farm loans they now seek to aggressively win for non-farm purposes. This diminishes the number of rural lenders in America. The FCA actions therefore threaten the availability of credit to rural America as this Congress created this GSE.

Again, thank you. I am happy to respond to any questions.

[The prepared statement of Mr. Williams follows:]

PREPARED STATEMENT OF SEAN H. WILLIAMS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE FIRST NATIONAL BANK OF WYNNE, WYNNE, AR; ON BEHALF OF INDEPENDENT COMMUNITY BANKERS OF AMERICA

Introduction

Mr. Chairman, and Members of the Subcommittee, thank you very much for the opportunity to testify today on a topic of great interest to everyone in rural America including particularly the community banking industry. The availability of credit to rural America is vital for our nation's farmers and ranchers, and the thousands of community banks that serve rural America.

My name is Sean Williams. I am President and CEO of the First National Bank of Wynne in Wynne, Arkansas. I testify today on behalf of the Independent Community Bankers of America (ICBA). Our bank is a forty-six year member of ICBA.[1] Our bank is a long-time member of the Arkansas Community Bankers Association.

First National Bank of Wynne

Wynne is located approximately 60 miles northwest of Memphis, or 120 miles northeast of Little Rock. First National Bank of Wynne was established in 1915, providing financial services for almost 100 years. Our bank has branches in five communities throughout the region; nearly 80 employees; approximately $285 million in total assets and a $150 million loan portfolio. Seventy percent of our loans focus on farmers and the remainder serves businesses that supply farmers or are depend on their financial health for survival.

On a personal level, agriculture and the availability of credit are very important to me. I was born and raised on a farm in a northeast Arkansas community near McCrory. My father, grandfather and I raised rice and soybeans. I worked on the farm while attending college and also for several years after beginning to work in the financial services industry. My farming background led me to pursue both a bachelors and masters degree in agricultural business and economics from Arkansas State University.

[1] **About ICBA**

The Independent Community Bankers of America® (ICBA), the nation's voice for nearly 7,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. ICBA members operate 24,000 locations nationwide, employ 300,000 Americans and hold $1.3 trillion in assets, $1 trillion in deposits and $800 billion in loans to consumers, small businesses and the agricultural community. For more information, visit *www.icba.org*.

Focus of Our Testimony

Mr. Chairman, our testimony this morning focuses on how our bank and community banks in general serve rural America; the key factors that influence credit availability in rural America; the effects of competition in influencing credit availability and the results of a brief survey conducted with ICBA's Agriculture-Rural America committee.

However, I want to stress up-front the vast majority of bankers believe credit availability is plentiful and competition for loans is intense. To the benefit of farmers and ranchers, interest rates are at or near historically low levels.

Serving Our Community; Serving Agriculture; Serving Main Street

Like most community banks, our bank's employees serve our communities by volunteering in many civic organizations, churches, city councils, school boards, and other activities.

First National Bank is one of the largest agricultural lenders in the State of Arkansas. Our employees know the people who bank at First National Bank and care about their success. We are predominately a farming region where the economic impact of farmers and their success is critical to the economic fortunes of our communities. Our market is row crop agriculture where rice, soybeans and corn are produced. Cotton, wheat and milo are other crops raised in our area. First National Bank provides the vital credit that farmers need to be successful.

On a broader scale, community banks play an important role in the nation's economy. There are approximately 7,000 community banks in the U.S. and the vast majority of these are located in communities of 50,000 or fewer residents. Thousands of community banks are in small, rural, and remote communities across our nation.

While community banks comprise just 20 percent of the banking industry's assets, institutions with less than $10 billion in assets provide nearly 60 percent of the industry's small-business loans. According to the Federal Deposit Insurance Corporation's third quarter 2013 industry data, small-business lending at banks with less than $1 billion was up 3.8 percent from the previous quarter and 3.0 percent from the previous year.

This is important since small businesses represent an astounding 99 percent of all employer firms and employ ½ of the private sector workforce. In addition, the more than 26 million small businesses in the U.S. have created 70 percent of the net new jobs over the past decade. Small businesses are important in rural America since many farmers and/or their spouses have off-farm jobs. As small businesses ourselves, community banks specialize in small business relationship lending. When our customers do well, community banks do well.

Community banks under $500 million in assets extend about 50 percent of all agricultural credit from the banking sector. In addition, commercial banks under $1 billion in asset size extend approximately 56 percent of non-real estate loans to the farm sector and about 62 percent of all real estate credit from the banking sector.

Farm Bill and Crop Insurance

There are a number of factors that determine whether credit is available in rural America. Congress achieved an important objective in February when the President signed the new farm bill into law. The farm bill includes a number of programs that provide an economic safety net for the nation's farmers and ranchers.

These programs will provide farmers the choice of reference prices, formerly known as target prices, or the new Agriculture Risk Coverage (ARC) program on either a whole farm basis using individual farm data or an individual crop basis by using county based data. Cotton producers will have a new STAX program. The cyclical nature of agriculture and the uncontrollable risks of severe adverse weather combined with unknown commodity prices and costs of production expenses require a continued safety net for farmers and ranchers.

These programs are intended to complement a strong crop insurance program going forward and supplement crop insurance by providing support in periods of multi-year price declines and helping producers cover the crop insurance policy's deductible.

In 2013, over 86 percent of insurable acreage was covered by Federal crop insurance in the U.S., over 290 million acres. Crop insurance protected $1.6 billion of cropland in Arkansas last year. Crop-hail insurance provided an additional $1.5 billion in liability insurance for Arkansas crops. This is very important since nearly 90 percent of Arkansas farms are less than 500 acres in size.

Crop insurance is essential as it allows community banks security for loan repayments if disastrous weather strikes. It is very important that Congress not diminish the crop insurance program by adopting amendments that restrict the ability of producers to enroll or discourage producers from obtaining high levels of coverage.

Guaranteed Loan Programs

The farm bill also continues the important guaranteed operating loan and guaranteed farm ownership (real estate) loan programs. Importantly, as ICBA requested, the farm bill also wisely removes the arbitrary 15 year term limit on guaranteed operating loans. This change ensures thousands of family farmers can continue farming utilizing credit extended by private sector community banks.

We are pleased the agriculture appropriations bills also contain funding levels adequate to meet loan demand. These programs are almost entirely self-funding.

The farm bill's farm programs, combined with guaranteed loan programs and a strong crop insurance program are essential elements allowing community banks to ensure adequate credit is available to our nation's farmers and ranchers.

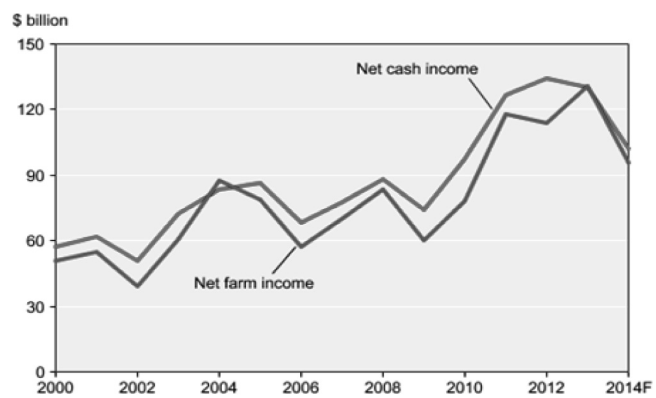
Farmer Mac

Another important tool for agricultural lenders is Farmer Mac, the secondary market for agricultural real estate loans and rural residential mortgages. Farmer Mac offers community bankers the opportunity to provide farm customers access to longer term, fixed rate mortgages. These loans, when sold to Farmer Mac's secondary market, allow lenders to replenish their existing funds so they can then make additional loans. As interest rates rise in the future, which they inevitably will, Farmer Mac will become an even more important program as farmers seek to lock in long term rates.

Some Concerns for Agriculture

A farm safety net is vital to agriculture and rural America due to the uncertainty, volatility, weather and cyclical nature of agriculture. Many farmers and ranchers and their lenders were concerned at the start of this year about the potential for lower farm income. In some areas, lower farm income is expected due to the severe drought impacting many Western states. In other areas, a large corn crop is expected to continue the downtrend in corn prices which began last year. Soybean prices are expected to be down as well.

Net Farm Income and Net Cash Income, 2000–2014F



Note: Data for 2013 and 2014 are forecasts.

Source: USDA, Economic Research Service, Farm Income and Wealth Statistics.

Data as of February 11, 2013.

http://www.ers.usda.gov/ersDownloadHandler.ashx?file=/media/1013171/net-farm-income-and-net-cash-income.png

For example, USDA projects that net farm Income will decrease about 27 percent in 2014 to approximately $96 billion led by a projected $11 billion decline in corn receipts and a $6 billion decline in soybean receipts. Net cash income, projected at $102 billion, is projected to be down 22 percent from the $123.5 billion achieved in 2013.

Although USDA notes net farm income will still be $8 billion above the previous 10 year average, we point out the last time we testified before this Subcommittee in 2012, the net farm income projection was $16 billion above the previous 10 year average.

Although production expenses will be down slightly, by about $4 billion, 2014 is expected to still mark the second highest year ever for production expenses and

farmers and ranchers have witnessed an 85 percent increase in production expenses from 2002 to 2013.

Additionally, USDA's Economic Research Service (ERS) noted recently that high operating costs, along with a sharp drop in prices, contributed to an 18 percent decline in net returns to corn operators from 2012 to 2013.

Fortunately, the ag economy has experienced record price levels in recent years allowing many farmers to pay down their debt load. Livestock producers are also now benefitting from lower feed costs and higher prices providing them much needed profits. The rapid rise in farmland values has slowed or stalled meaning that land prices are expected to be stable or slightly decline in the near future if crop prices continue declining or remain below the cost of production.

Federal Reserve Agriculture Perspectives

The Federal Reserve districts conduct quarterly surveys of agricultural bankers to determine their views on agricultural credit conditions. We have summarized a few of these surveys from the first quarter of 2014.

Little Rock Zone Ag. Bankers' Expectations Q1–14 *vs.* Q1–13

	Lower	Higher	Net
Loan demand	20	20	0
Available funds	0	20	20
Loan repayments	20	0	−20
Farm income	29	14	−14
Capital expenditure	29	29	0

Federal Reserve Bank of St. Louis Survey of Agricultural Credit Conditions [2–3]

Producers are concerned about lower corn and soybean prices and high input costs. Lower feed prices will help producers retain cow herds. Quality farmland prices fell slightly in the first quarter, a reversal of the gain reported in the fourth quarter of 2013. However, quality farmland prices in the first quarter were 7.5 percent higher than a year earlier. Bankers continue to expect farm income and quality farmland values to decline over the next 3 months compared with year-earlier levels.

Interest Rates

	2014:Q1	2013:Q4	Change
	Interest Rates (%)		
Operating:			
Fixed	5.28	5.39	−0.12
Variable	4.84	5.01	−0.17
Machinery/Intermediate term:			
Fixed	5.53	5.65	−0.12
Variable	5.02	5.21	−0.19
Farm real estate:			
Fixed	5.20	5.23	−0.03
Variable	4.77	4.93	−0.16

Similarly, bankers also expect farm household expenditures and farm equipment expenditures in the second quarter to be lower than a year earlier. The Saint Louis Fed noted their survey included an important conclusion: The vast majority of bankers' indicated the expectation of lower farm income in 2014 has not changed the highly competitive agriculture loan market.

[2] Federal Reserve Bank of Saint Louis, Agricultural Finance Monitor, First Quarter, 2014. *http://research.stlouisfed.org/publications/afm/2014/afmq1.pdf*.

[3] *Burgundy Book, A Report on Economic Conditions in the Little Rock Zone,* First Quarter, 2014.

Federal Reserve Bank of Kansas City 10th District Agricultural Credit Conditions [4]

Crop producers faced tighter profit margins although livestock producers experienced improved profits. Lower corn and soybean prices and relatively high input costs limited farm income and cropland values. Winter wheat growers were concerned poor yields would limit profits despite a rally in wheat prices. With lower income, more crop producers borrowed to pay for operating expenses. Bankers saw higher levels of carry-over debt *versus* a year ago.

Cropland prices have generally stalled due to expectations of lower profits. The value of nonirrigated farmland dipped 1.4 percent from the fourth quarter of 2013 to the first quarter of 2014, and irrigated farmland values rose just 0.5 percent. Higher incomes for livestock producers resulted in slight increases in ranchland values.

Funds for farm loans remained sufficient to satisfy additional borrowing and interest rates on farm loans remained steady. Most bankers indicated collateral requirements were unchanged despite a slight decline in loan repayment rates.

Federal Reserve Bank of Minneapolis Agricultural Conditions Survey [5]

Reduced crop prices and high input costs continue to take a financial toll on farmers and may be putting downward pressure on land prices. The outlook for the second quarter of 2014 is downbeat, with bankers predicting further declines in incomes, capital expenditures and household spending. Bankers indicated crop producers face tighter profit margins but livestock producers are more profitable with lower grain prices.

Even with the drop in incomes, agricultural producers maintained their rate of loan repayments, but renewals increased slightly. Loan repayments were unchanged for 75 percent of bankers, while 13 percent reported repayment rates decreased.

A quarter of lenders reported increased loan demand, while another ⅔ experienced no change. The amount of required collateral increased slightly, with 92 percent of bankers reporting no change. After several years of very strong growth land prices have moderated, a trend that continued in the first quarter. Values decreased in some cases along with cash rents. Land values fell the most in Minnesota, where nonirrigated cropland prices dropped eight percent compared with a year earlier.

Federal Reserve Bank of Chicago AgLetter [6]

Increases in farmland values in some areas contrasted with decreases in others. Demand to purchase agricultural land was weaker in the 3 to 6 month period ending March 2014 than 1 year earlier, yet pockets exist where farmers remained interested in buying more land.

Percent Change in Dollar Value of "Good" Farmland

	January 1, 2014 to April 1, 2014	April 1, 2013 to April 1, 2014
Illinois	−4	0
Indiana	−4	+7
Iowa	+1	−2
Michigan	−3	−1
Wisconsin	+1	+2
Seventh District	−1	+1

Demand for non-real-estate loans was up relative to a year ago for a second straight quarter, which hadn't occurred in 4 years. The availability of funds to lend improved compared with a year earlier, but repayment rates for non-real-estate farm loans were lower than a year ago. There were higher levels of renewals and extensions of these loans. The average loan-to-deposit ratio remained close to 67 percent for the third quarter in a row. Interest rates moved lower during the first quarter and a record low rate was set for feeder cattle loans. The livestock sector returned to profitability as milk, hog and cattle prices rose sharply (31 percent, 48

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[4] Federal Reserve Bank of Kansas City, Survey of 10th District Agricultural Credit Conditions, First Quarter, 2014. *http://www.kc.frb.org/research/indicatorsdata/agcredit/#/articles/research/agcredit/05-15-2014/farm-income-land-values-soften-further.cfm.*

[5] Federal Reserve Bank of Minneapolis, First Quarter 2014 Agricultural Credit Conditions Survey, *http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=5318.*

[6] The *Agricultural Newsletter from the Federal Reserve Bank of Chicago,* Number 1964, May 2014 *http://chicagofed.org/digital_assets/publications/agletter/2010_2014/may_2014.pdf.*

percent and 19 percent) since April 2013. Lower feed costs raised livestock profits helping support farmland values in some areas.

Survey Results of ICBA's Agriculture-Rural America Committee

ICBA conducted a survey of its Agriculture-Rural America committee in June to get our bankers' views on credit availability in rural America. ICBA's Agriculture-Rural America committee consists of twenty-five bankers from every geographical region of the U.S. representing most agricultural commodities produced in the United States.

The survey asked bankers whether credit is plentiful, adequate or constrained in their area. No bankers felt credit was constrained and nearly all members stated credit was plentiful in their marketplace. We asked banks if they would desire to make more agricultural loans if demand existed. All bankers stated they desired to make more agricultural loans.

Record high commodity prices over the past 4 years, combined with good yields in many areas, has generated significant cash for producers, allowing them to pay down term debt, pay cash for capital purchases and has reduced the need to borrow for operating expenses. Banks are very liquid, allowing them ample funds to make more farm and rural loans. Regulators, of course, want to ensure that farm loans can cash flow.

We asked bankers if they believed their customers' farm income and farmland values would increase, decline or remain stable. Generally, bankers stated farm income and farmland values would decline or remain stable. Some bankers felt farm income would increase, reflecting their customers' involvement in livestock operations.

A large majority of bankers responded crop insurance is essential, allowing them to make loans to farmers and most bankers could not extend loans to most customers without the assurance of repayment which crop insurance provides. As a banker stated, "our ability to lend would be hurt dramatically without crop insurance."

Regarding farm bill programs, most bankers felt the farm bill was also indispensable to their ability to make farm loans. Regarding program options, most bankers felt the new reference prices were adequate but would not cover production costs. Most bankers also felt there was not enough information for customers to choose which farm program to sign up for. Most banks said they would work with their customers to help them decide farm program options.

Farm Credit System Abuses

We asked bankers several questions related to activities of the Farm Credit System (FCS). FCS is a tax advantaged, government sponsored enterprise given tax and funding advantages by Congress in the early years of the previous century. The expectation was that FCS would provide farmers and ranchers access to credit at a time when such access was much more limited than today, particularly for long-term, fixed-rate financing. However, the banker responses discussed below are quite troubling in terms of FCS abuses of their GSE advantages.

We asked bankers whether they had lost loans to the FCS and if so, was this a result of the FCS undercutting banks on their loan rates or a result of the FCS providing better service? Nearly all bankers said they had lost loans to the FCS and this was a result of FCS undercutting loan rates and in no case did bankers say that FCS provided better service.

Next, we asked if banks had lost loans to FCS due to FCS undercutting loan rates, was FCS targeting primarily the bank's financially strongest customers or a broad mix of customers based on financial strength. Nearly all bankers stated that FCS exclusively targets their best customers in terms of financial strength. As one banker stated, "I haven't seen FCS take any customers except the best and the biggest."

We asked bankers whether FCS was making non-farm loans in their marketplace. Several banks stated that FCS was indeed making non-farm loans. An example provided were FCS lenders making rural hospitals loans (an authority the FCS has never been granted by Congress).

The Harmful Impact of FCS Actions on Credit Availability to Rural America

We asked bankers if FCS activities undermine community banks' ability to make agricultural credit available in their market. Bankers believed this is the case and noted FCS targets the best operations, attracting these businesses through low rates which community banks are unable to match since they lack the tax and funding advantages of a GSE. Community banks cannot match the below market rates FCS offers to the best customers and still remain profitable. One banker noted there is

stiff competition among all banks in his area; however, they cannot match the low rates offered by the FCS to the best customers.

The large, more stable operations are important to community bank portfolios as they spread lending risks over both small and large operations. By targeting the large and financially strongest borrowers, FCS elevates the risks in community banks' farm loan portfolios.

As one banker explained, "Almost every community and regional bank in our market is more than willing to make agricultural loans (operating, equipment and real estate), yet find ourselves undercut by FCS in all those categories."

As another banker stated, "Not only is there an issue with FCS lenders cherry picking the best loans in community bank portfolios, but also when FCS urges the newly acquired customers to move their deposit accounts to one of the large banks, thus taking deposits out of local, small communities and hurting the economic base of these remote, rural communities. This hurts community banks' ability to loan funds locally because of lower deposit balances."

Another example of a questionable lending practice by the FCS was a banker's comment noting they had lost a large real estate loan to the FCS because FCS was willing to take a minimal down payment while financing *93 percent* of the real estate debt. The banker noted this is the type of practice common in the 1980s that led to the ag credit crisis and does not put borrowers in a healthy financial position. Borrowers with heavy debt loads ultimately lost farms in the 1980s.

FCS almost exclusively targets top borrowers; offers these targeted borrowers below market rates and is willing to fix those below market rates at longer terms. By taking top borrowers from community banks, FCS weakens the overall community bank portfolio, and leaves the less seasoned/younger borrowers and higher leveraged borrowers with community banks. Similarly, if community banks stretch to keep top borrowers, community banks must accept less return and assume more interest rate risk by fixing the rate for a longer period.

Bankers typically stated the FCS largely ignores young, beginning and small farmers. As one banker stated, "FCS wants us to get these types of farmers started first and then later attempts to take them away once they become financially stronger."

FCS Mission Creep

We remind the Subcommittee the FCS is a GSE, granted several unique advantages not afforded to the private sector. These advantages were intended to allow the FCS to serve the specialized niche of agricultural producers and their cooperatives. However, we are seeing the FCS run amuck into non-farm related activities.

The FCS's regulator, the Farm Credit Administration (FCA), is complicit in aiding and abetting this unauthorized behavior. The FCA works hand-in-hand with FCS to expand the customer base of the FCS even though Congress has said no to the FCS's non-farm legislative agenda.

Illegal Investment Schemes: Through its 'Investments in Rural America' (*i.e.,* also termed by FCA as 'mission related investments') proposal, the FCA has sought to grant FCS powers to engage in practically all types of non-farm lending. These activities were initially granted as 'pilot projects' enabling FCS lenders to engage in loans to hospitals, commercial offices (doctors, lawyers), manufacturing, apartment complexes, hotels and motels, *etc.* While their initial proposal to grant national, blanket authority by regulation for these activities was withdrawn, the FCA is now proposing allowing these same activities if approved by FCA on a case-by-case basis. We point out these are loans, not 'investments' and they are inconsistent with the statute's focus on agricultural based lending. FCA needs to stop playing name games, calling loans 'investments' and stick to the laws Congress passed.

$725 Million Verizon Loan: Additionally, the FCA apparently was unaware that CoBank, the FCS's large lender to cooperatives, had made a $725 million loan to Verizon to buyout Vodafone's interest in a joint venture. Verizon and Vodafone are headquartered in New York City and London and this extremely large loan was not rural-based, nor is it an allowable lending activity. While the FCA has excused this illegal loan as eligible under the Farm Credit Act's 'similar-entity' provision, this provision was never intended to allow FCS lenders to make loans that are completely different from loans that are eligible under the statute. FCA is again abandoning their regulatory oversight responsibilities in an effort to go to any length necessary to allow FCS lenders to make whatever types of non-farm loans they desire.

$10 Billion Line of Credit: On September 24, 2013, the Treasury Department, through its Federal Financing Bank, entered into a $10 billion note purchase agreement with the Farm Credit System Insurance Corporation (FCSIC) to establish a standby line of credit to provide FCS lenders funds at the Treasury's cost of funds.

This line of credit, which the FCA sought in secret, raises a number of serious questions. For example, why did the FCA seek a $10 billion line of credit at a time when FCS lenders were reporting record profits of $4.64 billion in 2013? Why did the FCA not seek Congressional approval?

When the FCS failed in the 1980s, the farmland values which the FCS utilized as collateral had collapsed. Yet, the $10 billion line of credit, according to FCA is "collateralized" meaning that the collateral backing for this line of credit could be dramatically reduced. If the FCS were to collapse, as it did in the 1980s, American taxpayers would be on the hook for the bailout.

It would appear the FCA and FCS desired to lower their borrowing costs even further by acquiring this line of credit. The FCSIC was created to collect premiums from FCS institutions as a backstop in the event of financial deterioration within the System. Why then did the FCA seek and obtain a line of credit from the Treasury's FFB as additional protection?

Further, a report [7] to the FCSIC prepared by the Brookings Institution on behalf of the FCSIC stated: "*FCS should be required to approach the Congress* and the Administration for legislative help (emphasis added)." Yet, **FCA did not go to Congress** but secretly went to the Treasury to obtain the line of credit.

Mr. Chairman, we could raise a number of additional issues regarding FCS abuses. We believe these types of issues and questions warrant a series of separate hearings.

There are many concerns Congress should explore in their oversight capacity of the FCS. Understandably, Congress has been knee-deep in writing a farm bill in recent years. However, Congress should not lose sight of this GSE's activities particularly when Congress is debating what to do with the housing GSEs. Certainly this GSE needs to have greater scrutiny.

Conclusion

Mr. Chairman, thank you for the invitation to testify. As explained, there is a plentiful amount of credit available to farmers and ranchers at very low interest rates. Community bankers and their customers will continue to look forward to implementing the new farm bill and we thank you for your hard work on the legislation. We also thank you for ensuring a strong crop insurance program and continuing the guaranteed loan programs with greater flexibility.

However, more attention and scrutiny needs to be paid to the FCS's inappropriate activities and their unauthorized actions as well as to the FCA's *laissez-faire* attitude towards regulating the mission of this GSE, particularly the expansion of their scope and eligibility parameters.

The purpose of today's hearing is to examine credit availability in rural America. However, the actions of the FCS undermine the availability of credit in rural America as they seek to drive out other providers of credit by leveraging their unique GSE advantages in their efforts to lend to the very best customers and often ignoring producers in a weaker financial position. Is that really what the purpose of a GSE should be?

We look forward to working with you in the future. Thank you.

The CHAIRMAN. Thank you, Mr. Williams. I now recognize Mr. Brett Melone, Loan Officer, California FarmLink, Santa Cruz, California, on behalf of the National Sustainable Agriculture Coalition. Mr. Melone, you are recognized for 5 minutes.

STATEMENT OF BRETT MELONE, LOAN OFFICER, CALIFORNIA FARMLINK, SANTA CRUZ, CA; ON BEHALF OF NATIONAL SUSTAINABLE AGRICULTURE COALITION

Mr. MELONE. Thank you. Good morning, Chairman Crawford, Members of the Committee. It is an honor and a pleasure to address you this morning and talk about credit availability in particular for small, beginning and socially disadvantaged farmers.

Again, my name is Brett Melone. I am a loan officer with California FarmLink. We are a nonprofit agricultural lender based in

[7] The Brookings Institution: *Farm Credit System Liquidity and Access to a Lender of Last Resort,* Report for the Farm Credit System Insurance Corporation, page 8, Kohn and McGarry; *http://www.brookings.edu/~/media/research/files/papers/2012/11/06%20farm%20credit%20system%20liquidity%20kohn/06%20farm%20credit%20system%20liquidity%20kohn.pdf.*

Santa Cruz, California. And, again, a member of the National Sustainable Agriculture Coalition.

FarmLink's mission is to link independent farmers in California with the land and financing that they need to be successful. We provide micro and small business loans, lines of credit and technical assistance. As a statewide nonprofit, our—the farmers that benefit from our lending are primarily low to moderate income farmers, about ⅓ are very low income. We do take advantage of the Federal programs available to us to serve this population, in particular FSA guaranteed program, the rural micro-entrepreneur assistance program, and recently within the last year became a certified community development financial institution, one of the few agriculturally focused CDFIs in the country.

The typical assistance services and financial products that we provide have a strong focus on high risk populations. FarmLink's development services focus on farm financing, cash flow protections, credit counseling, financial management and land access strategies. We see this technical assistance as critical not only to their business' success but simply for them to be able to access the financing that they need to grow their businesses. Due to the cost of making these micro and small loans, most banks and commercial lenders don't want to make them. Building a pipeline of viable loans requires relationships with farming communities that commercial lenders generally lack. And, again, it takes time in the form of technical assistance to get applicants to the point where they can actually qualify.

As we have heard, the FSA microloan program became permanent, and we applaud that. I think this is really going to help increase access to capital for this farming population, and in addition the lifting of the term limits so that beyond the microloans they will be able to have full access to those programs. The increased—we would like to thank the Agriculture Appropriation Subcommittee for increasing funding for FSA direct loans, and also ask you to think about as FSA seeks to continue access to credit for farmers who have not historically used FSA loans, it will be imperative to ensure FSA has the administrative and staffing resources to serve this growing demand.

As the first organization in the country to offer agriculture individual development accounts and a champion of the effort to establish a national program, we are pleased to see the reauthorization of this program in the 2014 Farm Bill. And we urge you to work with your colleagues on the Appropriations Committee to fund this program for $2.5 million in Fiscal Year 2015.

The 2014 Farm Bill authorized USDA to develop the Whole-Farm Revenue Protection Program, and this is a welcome addition to the risk management toolkit for sustainable and organic producers, a segment of American agriculture that has historically been under-served by crop insurance. It is an important tool, crop insurance is, for lenders in mitigating their risk. And we urge you to work with the USDA to expand the coverage of this program nationwide, in our area in particular. Sustainable and organic growers have been left out of this program currently.

Section 6025 of the farm bill was revised and renewed. And this is Strategic Economic and Community Development. And we en-

courage you to work with the USDA in shaping how this program will serve the community and regional needs of agriculture and particularly around sustainable and organic where we are seeing significant growth in California.

The Rural and Micro-Enterprise Assistance Program was reauthorized in the farm bill with $15 million in mandatory funding over the 5 year cycle. We would also like to see an additional $3 million per year in discretionary funding for that program to meet the demand.

The Microloan Cooperative Lending Pilot Project, which we heard a little bit about earlier as well, we think this is going to really help FSA reach the farmers that are difficult to reach, serve them in a way that is going to meet their needs. So we urge USDA to work with partners to shape that program in providing underwriting support, guarantees and the like.

Thank you, Chairman Crawford.

[The prepared statement of Mr. Melone follows:]

PREPARED STATEMENT OF BRETT MELONE, LOAN OFFICER, CALIFORNIA FARMLINK, SANTA CRUZ, CA; ON BEHALF OF NATIONAL SUSTAINABLE AGRICULTURE COALITION

Introduction

Chairman Crawford, Ranking Member Costa, and Members of the Agriculture Subcommittee on Livestock, Rural Development and Credit, thank you for this opportunity to provide information about credit availability in rural America.

My name is Brett Melone. I am a loan officer with California FarmLink. FarmLink is a nonprofit lender based in Santa Cruz, California. FarmLink is also a member of the National Sustainable Agriculture Coalition. My remarks reflect the credit needs of farmers in California as well as nationally.

Both of my parents worked in agriculture when I was growing up in South Florida. I have dedicated my professional career to supporting the success of beginning, minority and small farmers, primarily in California, though I have been involved in national policy efforts, and spent a number of years living in Latin America as well. My commitment to these farmers comes from my first-hand knowledge of their ability to make a living in agriculture, provide jobs for others, feed the country, and steward our natural resources. This is what I am passionate about, and it is clear to me that a key factor in this farmer population being able to realize these goals is their ability to access capital.

Much has been done over the last several decades to create programs that provide business development services and access to credit programs for small businesses. Since the financial crisis this effort has increased. Microloans are now part of the vernacular for anyone that is interested in economic development. Crowd funding is also becoming commonplace. We are even hearing more about policy efforts to allow Direct Public Offerings, where individuals who are not certified investors can invest their savings in "Main Street" or in our case, regional farms.

Despite all of this activity and progress, there are still gaps between what farmers with $1 million or less in revenue can access in terms of capital. FarmLink recognized these gaps several years ago, and is now in its fourth year of direct lending to small, sustainable farmers. In 2011 we obtained Standard Eligible Lender status with the Farm Service Agency, and began making Rural Microentrepreneur Assistance Program loans. In 2013 we became a certified Community Development Financial Institution, one of just a handful nationwide that focus on agricultural lending.

California FarmLink is a statewide nonprofit serving Low-Income Targeted Populations (LITP) throughout the State of California with three regional offices in the North Coast, Central Valley and Central Coast. FarmLink's mission is to link independent farmers and ranchers with the land and financing they need for a sustainable future. FarmLink provides business development services, microloans, small business loans and small lines of credit.

FarmLink serves a target market across California of immigrant and other underserved beginning and small farmers. Since 2011, FarmLink has made more than 80 loans, deploying $1.5 million in capital to farmers, with an average loan size of $25,000, and loan size range of $5,000 to $100,000. In 2012, 63% of FarmLink's cli-

ents were at or below 80% of the Area Median Income (AMI) and approximately 24% were very low-income, at or below 30% AMI.

There are very few sources of small agricultural loans available to low-income and beginning farmers. The target market has a difficult time securing land and/or financing due to: limited history as entrepreneurs; limited traditional collateral; no or limited credit history; small loan size required; language or cultural barriers; and non-traditional marketing and business models.

The barriers to entry and to gaining stability for new and beginning farmers are formidable. According to the 2012 USDA Census of Agriculture, the average age of California's farmers has increased to 60. At the same time, beginning farmers lost ground. From 2007 to 2012, California lost more than 6,000 beginning farmers, a 23% drop, largely due to the economic downturn starting in 2008.

FarmLink knows from experience that the first 5 years of farming are the most critical. Many start-up farmers have developed solid production skills, but have not developed an ideal mix of market options, economies of scale, or business savvy to survive. While the number of beginning farmers declined over the last 5 years, the number of Latino farmers, many of them immigrants, increased by 8% to almost 10,000 farmers throughout California. In fact Latinos comprise about 70% of FarmLink's borrowers and 40% of farmers who receive one-on-one technical assistance on finances and land tenure.

Clearly, small farmers lack capital to expand. In a 2011 survey of 1,000 beginning farmers conducted by the National Young Farmers Coalition, 78% identified lack of capital as the biggest challenge to achieving success.[1] As the number of small and beginning farmers continues to grow, the financial products and technical assistance services offered by FarmLink are essential to ensure that these growers succeed.

FarmLink has made more than half of its loans in Monterey and Santa Cruz counties where farm labor income is seasonal and closely tied to minimum wage, creating endemic poverty in spite of chronic, seasonal labor shortages. Unemployment in Monterey County peaked at 17.5% 2 years ago in the winter months and peaked this past winter at 15%. Workers earning subsistence wages turn to self-employment in agriculture as a way to increase their income. These small and beginning farmers need access to capital and technical assistance to start, stabilize, or expand their farming business.

FarmLink's technical assistance services and financial products have a strong focus on higher risk populations. FarmLink development services focus on farm financing, cash flow projections, credit counseling, financial management and land access strategies. Our experience shows that one-on-one technical assistance and training is effective in helping farmers establish, operate and expand strong farm businesses and access and manage loans.

National Credit Context

FarmLink is part of a nascent movement of CDFI's working with farmer networks, and in particular, farmer networks that serve beginning farmers, farmers of color, immigrant farmers, and other farmers that have difficulty accessing credit through traditional means.

Current research funded by the Kellogg Foundation and being conducted by Michigan State University's Center for Regional Food Systems has documented the fact that very few farmer networks, and in particular farmer of color networks, are aware of the mission, structure and function of CDFIs. At the same time, even those CDFIs that have taken steps to increase their agricultural lending admit to having limited knowledge of the farming sector.

This research points to the need to be intentional, at a national level, to build the capacity of CDFI and other community lenders to serve agriculture. Specifically, the research recommends creating an agricultural lending caucus among CDFI's and Farmer of Color Networks that focuses on the development of short and long term policies and best practices, including designated funding for farmer network projects modeled after the Healthy Food Financing Initiative.

Due to the cost of making micro and small loans, most banks and commercial lenders don't want to make them. Building a pipeline of viable loans requires relationships with farming communities that commercial lenders generally lack. It takes time, in the form of technical assistance, to get the applicants to a point where they are ready to apply, and the underwriting requires knowledge of direct and alternative markets, that commercial lenders typically don't have.

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[1] Shute,"L.L." (2011) *Building a Future with Farmers: Challenges Faced by Young, American Farmers and a National Strategy to Help Them Succeed.*

Important Federal Policy Changes

Policy changes within the USDA, and in large part led by this Committee, have created opportunities for FarmLink and other community-based lenders, to begin to address the need for capital among this under-served farmer population.

On behalf of California FarmLink, the National Sustainable Agriculture Coalition, and NSAC's member organizations, and the farmers that we serve, I'd like to genuinely thank the Members of this Committee for their commitment to improving and increasing access to capital for beginning, small and minority farmers.

The FSA Microloan program that started out as a pilot program is now permanent—thanks to the efforts of this Committee during debate of the 2014 Farm Bill. Microloans made to beginning and veteran farmers will now be exempt from the term limits that otherwise apply on all direct operating loans. This important change will allow these farmers to continue to take advantage of Federal credit resources as they continue to grow their farm operations in the future.

Additionally, the Microloan Cooperative Lending Pilot Projects provision will allow USDA to work with nonprofit community lenders to expand access to microloans and financial training for small, beginning, veteran and socially disadvantaged farmers.

The increased priority on lending to beginning and socially disadvantaged farmers through FSA Direct and Guaranteed Farm Ownership and Operating loan programs will increase access to capital for these farmer groups. In addition, increased flexibility in determining what types of experiences should count towards the "farm management experience" requirement for direct farm ownership loans will further expand access to these loans.

The lower interest rate for Joint Financing (or Participation) loans that bring together farmers, USDA, and a private lender in order to leverage scarce Federal credit appropriations with private lending resources will harnesses the power of leveraging and will allow FSA to serve more farmers for the same amount of Federal appropriations.

We also thank the farm bill conference committee for continuing mandatory funding the Rural Microentrepreneur Assistance Program (RMAP) at the 2008 Farm Bill level of $15 million over the 5 year cycle. This program has been essential to FarmLink's ability to make loans to beginning, immigrant and small farms in California. In addition to the direct spending of $3 million per year, we would like to see discretionary funding of $3.3 million in FY15, consistent with the USDA request, and more robust discretionary funding in subsequent years. I urge you to work with your colleagues on the Appropriations Committee to get the $3.3 million request into the FY15 bill. Furthermore, we believe greater flexibility is needed in how the formula for technical assistance funds is applied, and urge you to work with USDA to achieve a workable solution to this problem.

As the first organization in the country to offer agricultural IDAs, and a champion of the effort to establish a national program, we were pleased to see the reauthorization of the Beginning Farmer and Rancher Individual Development Accounts (BFRIDA) Pilot Program, designed to help beginning farmers and ranchers of limited means finance their agricultural endeavors through business and financial education and matched savings accounts. As the age of the average American farmer continues to rise, now is the time to launch this important new credit tool, and I urge you to work with your colleagues on the Appropriations Committee to fund this program in FY15.

We'd also like to thank your colleagues on the Agriculture Appropriations Subcommittee for increasing funding for FSA direct loans. Historically low interest rates and lower default rates certainly have helped a great deal in increasing loan volume. In addition, agency leadership and staff are doing a great job increasing access to credit to farmers, despite dwindling staffing resources. For the first time in recent memory, there is no backlog in the number of farmers who have been approved but not yet received direct loans. As FSA seeks to continue access to credit for farmers who have not historically used FSA loans (including a growing number of microloans to smaller, diversified farms selling to local and regionally markets), it will be imperative to ensure FSA has the administrative and staffing support to service and provide technical assistance on the larger loan portfolio each office will likely carry.

The 2014 Farm Bill authorized USDA to develop Whole Farm Revenue Protection (WFRP). WFRP is a welcome and long-awaited addition to the risk management toolkit for sustainable and organic diversified farming operations, a segment of American agriculture that has historically been under-served by traditional crop insurance. Crop insurance is an important tool that lenders look at to evaluate a farmer's perceived risk in their farming operation. We therefore commend USDA for responding quickly under its new farm bill authority to develop WFRP in time for

the 2015 crop insurance year. In order to avoid suffering the same under-utilization as AGR and AGR-Lite, and to provide an appropriate and accessible risk management option for all producers in all states, it is critical that USDA develop and swiftly implement a plan to expand WFRP nationwide.

Finally, revisions to and renewal of Section 6025 of the 2014 Farm Bill, Strategic Economic & Community Development hold promise for supporting regionally significant economic development efforts. Local and regional governments are taking steps to support agriculture and rural economic development through planning efforts, and this program will leverage those efforts in synergistic ways. We urge you to work with local and regional partners to shape this program.

Strategic Partnership

Increasing consumer demand for local food and a growing recognition of the role of food systems in addressing rural economic development, public health, climate change preparedness, veteran transition to civilian life, among many other national issues, is driving farmer demand for micro and small loans all across the country.

FarmLink and FSA are strategic partners in facilitating access to credit. FSA's role as the lender of last resort/first opportunity is very complementary to FarmLink's role as an agriculturally-focused CDFI making relatively high risk loans. While there are loans that we would potentially both make, and thus be competing with one another, the reality is that FSA is reaching those farmers that feel comfortable going into the USDA Service Center, and FarmLink, as a community-based lender, is going to where borrowers are, in the field, and providing technical assistance to help them be loan-ready.

The power of leverage that comes with providing loan guarantees is tremendous. The Cooperative Lending Pilot Project represents an important opportunity to build on this leverage.

For example, the current drought in California is affecting farmers in diverse ways, depending on where they are located, and what their options for accessing water are in each location. California FarmLink is working to facilitate access to credit for these farmers who have water emergencies. Where possible, California FarmLink is making bridge loans to finance irrigation and water efficiency projects supported by the Environmental Quality Incentives Program cost-share. California FarmLink expects to begin conducting water audits later this summer for farmers, and connecting them with financing for irrigation and water development projects based on audit findings.

California FarmLink is also developing a farm mortgage product, in response to the growing demand and need we see from farmers in our region. We look forward to working with FSA to create a product that will serve the needs of our target market and ensure affordable and stable land tenure for the next generation of California farmers.

Farmer Profiles

In addition to the loans that FarmLink has made with FSA guarantees, which are an important part of our portfolio, have ranged from $25,000–$100,000, and include a diversity of production systems and business models, there are other ways that we support each other's efforts to facilitate access to credit.

The borrower target market for FSA and California FarmLink has some overlap, and each also has a distinct market. By way of example, this becomes clear by considering a few examples of mutual referrals:

- A well-established Community Supported Agriculture farm in Fairfield had obtained two FSA direct operating loans and was then referred to FarmLink in hopes of graduating to more conventional financing. They obtained an annual operating loan with an FSA guarantee from FarmLink for the 2013 season. For the 2014 season the borrower was able to "graduate" to a loan with Farm Credit West, benefitting from a lower interest rate and more flexible terms.
- A 12 acre direct market diversified organic fruit and vegetable operation in Humboldt County applied for a microloan from their local FSA office. For reasons that are not completely clear, the applicant was denied, but was referred to California FarmLink. FarmLink made an equipment and operating loan totaling $21,000.
- The FSA Farm Loan Officer in Modesto recently referred a borrower to FarmLink that has reached the term limit on FSA Direct Operating Loans, having received 7 years of Direct Operating Loans, and then an additional 2 years on waiver. FarmLink is likely to finance this bee operation, with the benefit of knowing the type of credit risk they represent.

- A start-up aquaponics operation in the Bay Area sought an operating loan from FarmLink. The borrower was a returning veteran who had completed a training program and apprenticeship, but his experience was not sufficient to meet FarmLink's underwriting standards. FarmLink referred the applicant to FSA, where he was able to obtain a microloan to launch his operation, producing specialty vegetables to restaurants.

These are just a few examples of farmers that have benefitted from the FSA-FarmLink relationship.

Key Policy Recommendations

As this Committee evaluates the current state of agricultural credit across the country, we would like to recommend a few ways that Congress and USDA could better meet the credit needs of our nation's farmers—especially those beginning, minority and small farmers who have struggled over the years to find adequate credit options needed to finance their farms.

First, we would urge the leaders of this Committee to sponsor an amendment to the Agriculture Appropriations bill to fund IDA's for the 2015 Fiscal Year. This is a program that this Committee authorized in the new farm bill. USDA sees this program as a key tool they need to recruit a new generation of farmers and has requested an initial $2.5 million to jumpstart the program next year. The Senate also recognized this need and the value this program could serve, and matched the Administration's request. I therefore strongly urge you to consider sponsoring an amendment to the appropriations bill in order to launch this important and long overdue credit resource for new farmers, and follow through on the House's commitment to this program.

Second, we would also urge the leaders of this Committee to work with stakeholders to shape Section 6025—Strategic Economic & Community Development. This updated provision prioritizes the funding of projects that are consistent with an adopted regional economic or community development plan. It will be important for the success of this program to be shaped by regional partners.

Third, we would urge the leaders of this Committee to work with USDA to expand coverage of Whole Farm insurance nationwide as soon as possible. The 2014 Farm Bill mandated a pilot program because organic and diversified vegetable growers have been pretty much excluded from Federal crop insurance. We believe the Congressional intent in the 2014 Farm Bill was to make the program available to farmers in the major organic and specialty crop growing areas—that would without question include Monterey and Santa Cruz counties. The pilot as currently described by USDA, relies on the current AGR and AGR-Lite designations for geographic coverage and crop specifics—which excludes key agricultural regions in California and other parts of the country. The lack of this risk management tool places these farmers and their creditors at a distinct disadvantage, relative to farmers who can access this program. We therefore urge you to work with USDA to expedite the process of making this program apply nationwide as soon as feasible.

Fourth, we urge this Committee to work with your colleagues on the Appropriations Committee to increase discretionary spending for Rural Microenterprise Assistance Program (RMAP). In addition to the direct spending of $3 million per year that this Committee provided in the farm bill, we would like to see an additional $3.3 million in discretionary funding for FY15 as requested by USDA, in order to meet the high demand for small business loans that exist in rural America. This too would be a high priority amendment to the pending FY15 agriculture appropriations bill.

Fifth, we urge this Committee to work with USDA to provide greater flexibility in the application of the formula that determines technical assistance grant awards under Rural Microenterprise Assistance Program (RMAP). We believe greater flexibility is needed in how the formula for technical assistance funds is applied. RMAP partners—like FarmLink—are at a distinct disadvantage in accessing technical assistance funds because they emphasize annual operating loans—with the associated faster pay down of those loans, followed by those funds being revolved out in the form of new loans—rather than longer-term equipment and infrastructure loans.

Finally, we urge leaders of this Committee to work with stakeholders and USDA to shape the Microloan Cooperative Lending Pilot Projects. The bulk of loans that FarmLink has made to date have been microloans. We have not sought guarantees on loans less than $25,000, due to the underwriting costs and guarantee fee. We are optimistic about the promise of this pilot program that may open new opportunities to make microloans while providing the much-needed technical assistance microloan applicants typically require, along with additional risk mitigation features. We are eager to see the new intermediary microlending option that this

Committee authorized rolled out across the country, and would urge you to work with USDA to ensure this option is available as soon as possible.

Conclusion

The face of agriculture in this country is undergoing dramatic transformations. Our Federal support structure and safety net has been adapting in response to these changes, and must continue to do so if we aspire to be efficient with our limited natural and financial resources, increase equity and fairness in our delivery of programs, and embrace those who seek to produce our food, fiber and fuel, now and in the future.

Thank you for the opportunity to provide this testimony on behalf of beginning, small and immigrant farmers and ranchers across the country. I look forward to answering any questions you have about their credit needs, and California FarmLink's efforts on their behalf.

The CHAIRMAN. Thank you. I appreciate it. And once again, I want to thank all the witnesses. I now recognize the gentleman from Texas for 5 minutes, Mr. Conaway.

Mr. CONAWAY. Thank you, Mr. Chairman. And, gentlemen, thank you for being here. Mr. Franz—Frazee, I am sorry. In your testimony, you had a couple of comments that I found interesting. One that you are working under a 40 year old law and that that is causing you challenges in your operations. Can you give us a couple of examples of where that is binding——

Mr. CONAWAY. Do I have a hand?

Mr. FRAZEE. Sure. I mentioned that we are seeing agriculture evolve. And I also indicated that we are focusing on trying to respond to the credit needs of an evolving agriculture that includes more local sustainable foods, urban oriented markets. And sometimes the authorities that we have are a bit challenging in terms of being able to provide the financing that is needed to support that infrastructure.

Mr. CONAWAY. So is this the rub that Mr. Wolfe and Mr. Williams talked about you are trying to push out beyond the original young farmer, beginning farmer, small farmer issue?

Mr. FRAZEE. I think what we are talking about aligns very well with the young startup issue, the kind of operations we are talking about that are locally or sustainable operations that are going to serve the farmer's markets here in the area.

Mr. CONAWAY. Okay. Well, I would like to visit with you about how the law itself is binding that up. You have also mentioned in written testimony you have provided—the System provided financially to $4.7 billion in exports. Can you put some meat on the bone as to what that meant?

Mr. FRAZEE. Yes, that is—those are authorities that are provided for CoBank to authorize export financing related to farmers, cooperatives——

Mr. CONAWAY. Is that directly related to rural America that——

Mr. FRAZEE. Pardon?

Mr. CONAWAY. That is where those exports are coming from, is that rural America?

Mr. FRAZEE. Correct.

Mr. CONAWAY. Okay.

Mr. FRAZEE. That is correct. It is all directly related to the ag production changes.

Mr. CONAWAY. All right. Mr. Wolfe, Mr. Williams, crop insurance both—I know Mr. Williams mentioned it. Could you talk about—is that a requirement on your loans to production farmers? And

what—I get both of you on the hook here to comment about the importance of crop insurance and the other risk management tools under the farm bill.

Mr. WILLIAMS. Yes. Crop insurance is extremely important to us in our portfolio. It is not required on 100 percent of our loans, but I would guess about 90 percent of our loans it is a factor. And so, certainly, maybe even more than 90 percent. But crop insurance is extremely important in allowing us to make a decision and having a comfort level with where the income base is going to be for that operation. The farm bill, the target prices and—is also something that is very important. But over the last 10 years, and certainly in the last 2 or 3, I have seen crop insurance play a bigger role than it ever has in risk management for farmers, and it is certainly important for banks.

Mr. CONAWAY. Mr. Wolfe?

Mr. WOLFE. Yes. We require crop insurance on 100 percent of our borrowers that we have—that we provide loans for crop production. And I ask our lenders last year to find a borrower at any level that didn't have crop insurance. We couldn't find any in our banks. So it is close to 100 percent of our borrowers, no matter whether they borrow money for crop production, but they do participate in that program today.

Mr. CONAWAY. All right. The FSA is under—and RMA are both trying to implement the changes to the farm bill. Any issues with the pace of that implementation and changes that are affecting your borrowers? Maybe——

Mr. WOLFE. What change are you referring to, sir?

Mr. CONAWAY. Say again.

Mr. WOLFE. What change——

Mr. CONAWAY. Well, we—based on changes to those risk management tools, and there would be the process of implementing those. Has it impacted this year's borrowings, lendings in production agriculture's, or something that they should be doing quicker than they are doing?

Mr. WOLFE. In our case, it has not. We typically do those on interim loans. We work very closely with USDA Farm Service Agencies in our area. And if there is the high likelihood that that is going to happen, we go ahead and provide interim financing for those.

Mr. CONAWAY. Right. So you are working—Mr. Williams, anything going on about that that we need to know about?

Mr. WILLIAMS. It has not had an impact on us either. We have about a $60 million operating loan portfolio, and about 20 percent of that volume is guaranteed by FSA guarantees. So we have been able to do that. It has been very efficient and hadn't caused any problems for us.

Mr. CONAWAY. Right. Mr. Melone, any issues with you?

Mr. MELONE. Yes, it is virtually nonexistent for our—the borrowers that we serve. And that is why we would like to see it go nationwide as soon as possible.

Mr. CONAWAY. Mr. Frazee, quickly, you keep 100 percent of your loans on your balance sheet. Is that a requirement or why do you do that?

Mr. FRAZEE. We keep our loans on our balance sheet for a couple of reasons. One, because we are a cooperative, and we want our members to benefit from the ability to have their loans on a balance sheet and receive patronage benefits. There are times that we may sell loans into a secondary market for risk management purposes. But substantially all, we keep on our balance sheet.

Mr. CONAWAY. All right. Thank you. I yield back.

The CHAIRMAN. The gentleman yields back. I now recognize the gentleman from Florida, Mr. Yoho, for 5 minutes—Mr. Yoho.

Mr. YOHO. Thank you, Mr. Chairman. I appreciate it. Let me see. Let me get back to my questions here. You were talking about—or let me ask you, is it——

Mr. FRAZEE. Frazee.

Mr. YOHO. Frazee. Mr. Frazee, do you guys classify under-performing loans and Farmer Mac the same way as Dodd-Frank and commercial loans used to do it? Like, say I borrowed $500,000 on a piece of property and was farming it, paid it off—paid on it on a 5 year note. Say I paid 3 years on it. And I have it paid down to $350,000. Land prices dropped, or the value of the land is now say $250,000. Traditionally, or with the Dodd-Frank, that was considered an under-performing loan, even though I didn't make a—miss a payment. Do you guys, in the Farmer Mac program, evaluate loans that way as under-performing?

Mr. FRAZEE. We use a risk rating system that is consistent with other financial institutions. It is a 14 point rating system that looks at the probability of default. We look at our loss given default. And, obviously, we have to comply with the standards that—our financial statements are audited by external auditors, Price Waterhouse Cooper. So——

Mr. YOHO. All right. Mr. Wolfe, how about you and your loan portfolio, if you have a loan in that kind of a situation, that illustration?

Mr. WOLFE. Well, we would recognize it as a troubled asset, if you will, and we would reserve higher for that. But, no, we wouldn't just, by the fact that it is under collateral, show it as a default.

Mr. YOHO. Okay. Because in some of the banking situations, correct me if I am wrong, I know they looked at it that way, and they said you have to get these off the book because it is an under-performing based on the rules of the Dodd-Frank. Now, they may have corrected that I heard in some of the smaller banks.

Mr. WOLFE. I think that applies to residential real estate loans, but not necessarily to ag loans.

Mr. YOHO. Okay. Let me ask Mr. Wolfe and Mr. Williams, do you feel you are in direct competition with Farmer Mac?

Mr. WOLFE. Well, not with Farmer Mac. No. Farmer Mac—what we do.

Mr. YOHO. With——

Mr. WOLFE. Farm Credit——

Mr. YOHO. Farm Credit?

Mr. WOLFE. Yes. Farm Credit is our largest competitor. We compete with local banks every day. But Farm Credit is our largest competitor and our biggest competition.

Mr. YOHO. Have you ever lost a loan based on competitive interest rates where they are more competitive than the interest rates that you can charge today?

Mr. WOLFE. Yes. I did—yes, we do every day—not every day.

Mr. YOHO. What causes that? Why is there that discrepancy? Why can you not adjust your interest rates where they can, or they can be more competitive?

Mr. WOLFE. Well, in Kansas, we have a state income tax that is applied to banks called a privilege tax that is 4.375 percent. We are also subject to 34 percent Federal income tax. And so when we have to give them a 38 percent head start, it does create some added competition for us. Yes.

Mr. YOHO. What I would like for all of you to do is give some recommendations on how we can make this more equitable so that there is not this competition, so that in the next farm bill we can correct some of these inequities so that it—when it comes out to pass, we won't have these discussions. We will already have addressed them. Is—I would love for you guys to enter in some recommendations so that we can address those before they become an issue.

Mr. Melone, on the end, I have some questions for you. In what you do, are—what is the amount of loans you give you in a year's time?

Mr. MELONE. So last year—we have been lending since 2011. We have made about 90 loans, $1.5 million so far last year, 2013.

Mr. YOHO. Yes. And 100 percent of that money comes from the Federal Government, right?

Mr. MELONE. No. Probably about ⅓ of it directly, and about the same amount is FSA guaranteed. But we have investors that are banks and foundations as well.

Mr. YOHO. Okay. What is the failure rate of that?

Mr. MELONE. We have a two percent default rate.

Mr. YOHO. That is great.

Mr. MELONE. So we made about $900,000 in loans last year. We are looking to make $1.25 million this year, and doubling the number of loans that we are making to about 50 this year.

Mr. YOHO. Okay. I don't really have any more questions, other than my goal is to make agriculture remain a strong sector. And my working together with the information and the suggestions that you have, we can make better policies up here that will affect the availability of credit for our farmers to keep ag strong in this country so that we remain a leader in that. And I look forward to any comments, and always feel that you can reach out to our office. And I appreciate you being here.

The CHAIRMAN. The gentleman yields back. The chair now recognizes Ranking Member Costa for 5 minutes.

Mr. COSTA. Thank you. Thank you, Mr. Chairman. To any of the panel members, and maybe we will start with Mr. Melone. We heard a lot of things that we talked about earlier that have been positive with the farm economy. Obviously, with different regions of the country, especially the West as we talked, this multi-year drought has been devastating. But, we have the opposite conditions along the Mississippi River where we have floods that have been occurring. How do you believe that the impacts of floods and

droughts taking place concurrently will hit the overall outlook on the farm economy at the end of this year? Have you made some estimations?

Mr. MELONE. So as you probably well know, there is a lot of geographic variability even within California. For instance, about how the drought is affecting different farmers, depending on how they get their water.

Mr. COSTA. Right.

Mr. MELONE. We are seeing, probably, $\frac{1}{4}$ to $\frac{1}{3}$ of our portfolio being affected in some direct way by the drought. So we are looking at making bridge loans to farmers that are getting funding through NRCS.

Mr. COSTA. How about individual loans for well drilling?

Mr. MELONE. Yes. We are actually working on a couple right now, putting in new pumps as well, farmers that were getting water from the Central Valley Project, for instance, that now no longer have access to that water.

Mr. COSTA. Yes. As you know, we are looking at a 6 to 10 month waiting list just to get a well driller online. The costs for those wells are anywhere from \$$\frac{1}{2}$ million dollars to \$1$\frac{1}{2}$ million and higher. So these kind of loans are important. Let me move over to the dairy industry, which I spoke about with the first panel and the changes in the dairy title as a result of the 2014 Farm Bill. I noted we had some terrible years in 2009 and 2010 when we had milk prices at \$9 per hundredweight, and the input costs were far, far higher, and we had a number of significant bankruptcies in California to underline it. Are you, as lenders, being more selective on how you deal with the loans to dairies? And I don't know who would like to opine here first?

Mr. WOLFE. We do finance some dairies in northeast, north-central Kansas and southern Nebraska. And we haven't seen any large issues, except with the milk prices. That is something that is very difficult to manage for our borrowers, but it is something that they have gone out a little farther, contracted prices. It is limited on the upside, obviously. But there are some vehicles they can use, and we do require that if we finance. And we have half a dozen large— relatively large dairies that we finance out of our bank. But we do require forward pricing.

Mr. COSTA. And so notwithstanding the volatility, your lending has remained somewhat constant?

Mr. WOLFE. Yes, it has.

Mr. COSTA. On that. Have any of you looked at—in terms of forward lending, under the new dairy title, the insurance program and how you anticipate that might factor in on future loans for dairies?

Mr. FRAZEE. We have looked at it. We think it provides some stability to the industry in looking at the credit risk around dairy. You know, as a cooperative and with the mission charge that we have to be there to provide for the income and wellbeing of farmers and to be a sustainable source of credit, we look at that as being something that helps to provide some stability in the industry and helps us to take a longer term view of the risk associated with those farmers.

Mr. WOLFE. I would agree.

Mr. COSTA. So you don't see any different application between those dairies that belong to co-ops and those that have a different process in which they sell their milk?

Mr. WOLFE. No, I don't. We finance both cooperative dairies and privately owned dairies.

Mr. COSTA. And do any of you have any reaction to the tax treatment on bonus depreciation under Section 179 provisions?

Mr. WOLFE. Would you restate the question, please?

Mr. COSTA. The tax depreciation that is allowed today——

Mr. WOLFE. Right.

Mr. COSTA. Do any of you think that it provides any more favorable conditions for lending that you are involved in?

Mr. WOLFE. Perhaps. Again, in our area specifically, Farm Credit System owns that space through their leasing programs. And we do a few farm building programs or farm sheds, if you will. But, primarily, that is owned by the Farm Credit System in our area.

Mr. COSTA. All right. Well, my time has expired. Thank you very much, Mr. Chairman.

The CHAIRMAN. The gentleman yields. I now recognize the gentleman from Iowa, Mr. King, for 5 minutes.

Mr. KING. Thank you, Mr. Chairman. And I thank the witnesses for their testimony. I would turn first to Mr. Wolfe and ask you, I believe you were in the gallery listening to the previous panel's testimony. And when I asked the question if the Farm Credit personnel could identify an independent bank rate that was lower than their rate for credit for our farmers, and they apparently could not do so. Were you surprised at their response?

Mr. WOLFE. No.

Mr. KING. And neither was I. But I would ask if you could speak to that issue, because I don't think we heard from your side of this.

Mr. WOLFE. Well, yes. I agree that it is—I mean, it is—she got into predatory lending. I don't think that is where you were going with that. You just wanted to know about general pricing. Pricing is very difficult for us to match, even the Farm Credit System in our areas, I mentioned before, in Kansas anyway, my specific bank, it is a 38 percent head start, 34 percent Federal tax, 4.375 percent for a state income tax. That is what makes it difficult to match fund—or match any rate that Farm Credit has out there.

Mr. KING. And would you have any comments to make on the mission creep question that I asked of the original panel?

Mr. WOLFE. Well, obviously, it has crept. I mean, the Verizon loan is one example of that. Frontier is another that has just been recently done. I don't think that that can be described by anything other than a mission creep. Their mission has expanded. The size of the Farm Credit System has doubled in the last 10 years. And it—they haven't done that all within traditional agriculture, I do not believe.

Mr. KING. Would it be your recommendation to this Congress to take a look at the mission and perhaps help write a mission statement since they write their own?

Mr. WOLFE. Absolutely.

Mr. KING. I thought it might. I don't know if that was in your original testimony. I was called away. Was it?

Mr. WOLFE. No. No, it wasn't. But, absolutely, I would support that.

Mr. KING. And, Mr. Williams, your comments on this subject matter?

Mr. WILLIAMS. Yes, I would echo Mr. Wolfe's comments. But, specifically, in east Arkansas, I could provide about 30 examples over the last 3 years where we have lost a borrower to the Farm Credit System. And without exception, it is a rate issue. So what we see is typically 150 to 200 bases points difference in short-term rates. And then, of course, as you stretch out our real estate lending, it even widens out from there. So time after time after time, we see it. And it is always based on rate.

Mr. KING. Could you speak to the scope of your competition's real estate loans, how broad that scope might be?

Mr. WILLIAMS. Yes, it is pretty well formed in our area. But we have also seen the scope widen from the Farm Credit System over the past couple years to things like lumber companies and things of that nature. So it appears, from our perspective, that there is not a lot of restriction in what they can or can't do. And we certainly are willing to compete and want to compete. And I have in Wynne—we have seven banks in Wynne that we compete with every day, as well as the Farm Credit System. So we are not afraid to compete. We just would like to do it with a level playing field.

Mr. KING. What about non-farm, say grain handling or processing, is that also a field of competition?

Mr. WILLIAMS. Absolutely.

Mr. KING. And what about residential?

Mr. WILLIAMS. Absolutely.

Mr. KING. Would that be urban, small town, as well as rural residential?

Mr. WILLIAMS. In our area, and we are pretty urban—Wynne's a population of about 8,000 people. But Farm Credit certainly is making housing loans in Wynne and in our entire market in eastern Arkansas.

Mr. KING. Thank you, Mr. Williams. Since I have asked you all these questions, Misters Wolfe and Williams, I should turn to Mr. Frazee and give him an opportunity to perhaps eliminate the other side of this.

Mr. FRAZEE. I appreciate that opportunity. First, the story I hear about competition are similar to what I hear from my loan officers about commercial banks. We are losing deals every day to commercial banks. It is a competitive environment. There is a lot of liquidity in the banking system. And we have seen pressure on our loans and our margins. So—and we think that is a good thing for customers, because ultimately farmers are going to benefit if they get lower rates. So we see that competition as well from banks that are losing loans.

Mr. KING. Mr. Frazee, if I would just ask this, if Farm Credit is at 46 percent of their real estate loans, as we heard in the previous panel, would there be a number that—if that number increased, would there be a number that you would think of that this Congress should be concerned about?

Mr. FRAZEE. I believe that the FCA panelist said that we had 41 percent of the total agricultural debt.

Mr. KING. Yes.

Mr. FRAZEE. That means that 59 percent, or the majority of it, is somewhere else with other lenders. So the majority of the agriculture of that is somewhere other than the Farm——

Mr. KING. But you would agree that 100 percent is too much?

Mr. FRAZEE. I would agree with 100 percent is too much.

Mr. KING. But we weren't going to agree on whatever that number might be in between 41 and 100?

Mr. FRAZEE. I think it ought to be—whatever the number is, it ought to be what is in the best interest of the farmers and ranchers of this country.

Mr. KING. I gave you the last word. Thank you, Mr. Frazee.

Mr. FRAZEE. Sure.

Mr. KING. I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman yields. And with that, we will dismiss the panel with our thanks from the entire Agriculture Committee. We appreciate you being here today.

Under the rules of the Committee, the record of today's hearing will remain open for 10 calendar days to receive additional material and supplementary written responses from the witnesses to any questions posed by a Member.

The Subcommittee on Livestock, Rural Development and Credit hearing is now adjourned.

[Whereupon, at 12:00 p.m., the Subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

SUBMITTED MATERIAL BY FARM CREDIT ADMINISTRATION

Insert 1

The CHAIRMAN. . . .

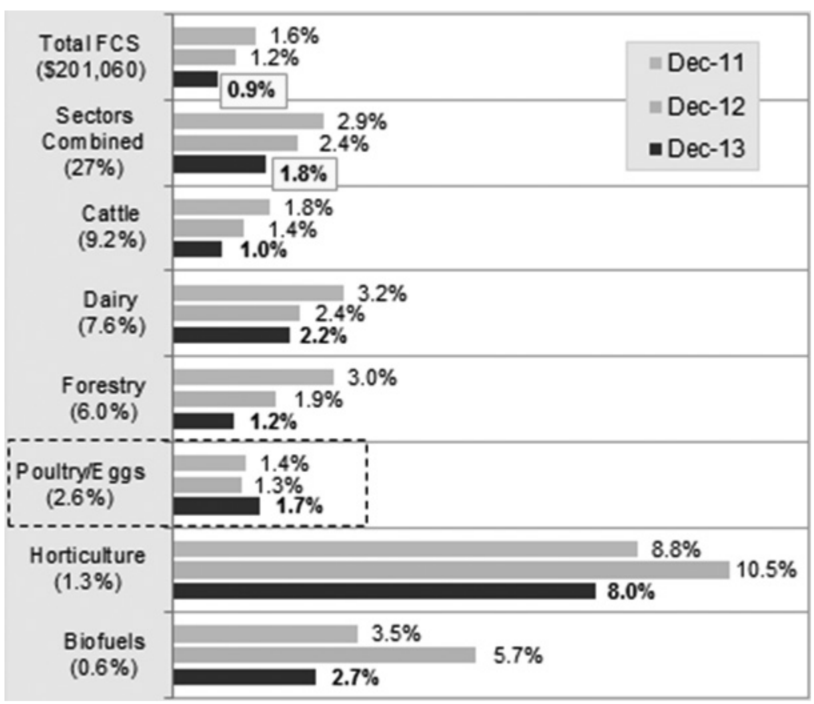
You testified that non-performing loans totaled $2.1 billion, which is a decrease of nearly $600 million. Is the non-performing loan portfolio—is that a geographic prerogative? Is it dominated by any certain sector of the ag industry, or is there a region in the country that may contribute more so than others?

Dr. LONG THOMPSON. Well, certainly, among those institutions that we regulate, if they happen to be located in a part of the country where there has been stress, you might see some additional—a higher level of non-performing loans. But we haven't detected a specific pattern geographically. I would, however, be very happy to provide you—we have very good data. We do analyses of the overall farm economy, as well as of the health of the System regularly. And we have some very good data that I would be happy to share with you and your staff.

Insert 2

Mr. ROGERS. Thank you, Mr. Chairman. That is what I was going to ask about. And I was late. And I am sorry. And I know that the Chairman visited this topic earlier. But one—the primary criticisms I get about the Farm Credit System is issuing loans in non-agriculture. And so do you know what percentage of the loan portfolio the Farm Credit System is issued to non-farm entities?

Dr. LONG THOMPSON. I think it probably would be best for me to get a detailed breakdown for you. But it is primarily agriculture and ag related. It is agriculture—and let me also say that, even though the System did not fall for the most part under the jurisdiction of Dodd-Frank, there are other kinds of rules that statute requires—for example, the territories, the districts that are established. So there are a number of restrictions in the Farm Credit System that simply are not restrictions in the banking sector. And I also think that there is a very strong case to be made for a group of farmers going together and setting up a cooperative model of lending, particularly when there is not always access in traditional banking.



Source: FCS Annual Information Statements.

Nonaccruals as a Percentage of Loans Outstanding

The chart shows nonaccruals as a percent of loans outstanding for the System as a whole and six key stressed sectors for the past 3 years. The nonaccrual rate for the six combined sectors is also shown.

The combined six sectors' nonaccrual rate was 1.8 percent at December 2013 compared to 0.9 percent for the System as a whole.

Each of the stressed sectors experienced improvement in 2013, except poultry and eggs.

The stress experienced by these sectors was due to the high corn and soybean prices of the past few years in the case of cattle, dairy, poultry/eggs and biofuels; and problems in the housing industry in the case of forestry and horticulture.

The percentage in parentheses indicates that sector's loan volume as a percent of total FCS volume.

The six stressed sectors combined accounted for 56 percent of all FCS nonaccruals at December 2013.

Farm Credit System Institutions Nonaccrual Ratio [1]

(as of 3/31/14)

AgFirst District		AgriBank District	
AgFirst FCB	0.3%	AgriBank FCB	0.1%
Ag Credit ACA	1.2%	1st Farm Credit Services, ACA	0.5%
AgCarolina ACA	2.0%	AgCountry ACA	0.6%
AgChoice ACA	1.7%	AgHeritage ACA	0.2%
AgGeorgia ACA	4.6%	AgStar ACA	2.0%
AgSouth ACA	1.3%	Badgerland Financial ACA	0.3%
ArborOne, ACA	1.2%	Delta ACA	0.9%
Cape Fear ACA	1.6%	Farm Credit Illinois, ACA	0.1%
Carolina ACA	1.8%	Farm Credit Mid-America ACA	1.2%
Central Florida ACA	2.3%	FCS Financial, ACA	0.5%
Central Kentucky ACA	1.0%	FCS of America ACA	0.4%
Colonial ACA	1.8%	GreenStone ACA	1.2%
FC of the Virginias ACA	1.4%	Mandan ACA	0.5%
First South ACA	0.3%	Midsouth ACA	0.2%
Florida ACA	6.5%	North Dakota ACA	0.4%
MidAtlantic ACA	1.1%	Progressive FCS, ACA	0.1%
Northwest Florida ACA	4.1%	United ACA	0.4%
Puerto Rico ACA	7.9%	Western Arkansas ACA	1.0%
River Valley AgCredit, ACA	2.1%		
Southwest Georgia ACA	0.0%		

CoBank District		Texas District	
CoBank ACB	0.2%	FCB of Texas	0.2%
AgPreference, ACA	0.0%	Ag New Mexico, FCS, ACA	2.5%
American AgCredit, ACA	0.9%	AgTexas FCS	0.2%
Central Oklahoma ACA	0.1%	Alabama ACA	0.3%
Chisholm Trail ACA	0.1%	Alabama Ag Credit, ACA	1.7%
Colusa-Glenn ACA	0.5%	Capital Farm Credit, ACA	1.2%
East Central Oklahoma ACA	2.1%	Central Texas ACA	0.0%
Enid ACA	0.7%	Great Plains Ag Credit, ACA	1.4%
Farm Credit East, ACA	1.2%	Heritage Land Bank, ACA	1.8%
Farm Credit West, ACA	1.4%	Legacy Ag Credit, ACA	1.7%
FCS Southwest ACA	1.4%	Lone Star, ACA	1.0%
Fresno-Madera ACA	0.0%	Louisiana Land Bank, ACA	0.6%
Frontier ACA	0.2%	Mississippi Land Bank, ACA	0.4%
Golden State ACA	0.0%	Panhandle-Plains FLCA	0.2%
Hawaii ACA	1.8%	Southern AgCredit, ACA	1.1%
High Plains ACA	0.0%	Texas FCS	0.3%
Idaho ACA	0.1%		
Ness City, FLCA	0.0%		
New Mexico ACA	1.9%		
Northwest FCS, ACA	0.9%		
Premier ACA	0.2%		
Southern Colorado ACA	1.2%		
Southwest Kansas ACA	0.0%		

Farm Credit System Institutions Nonaccrual Ratio[1]—Continued

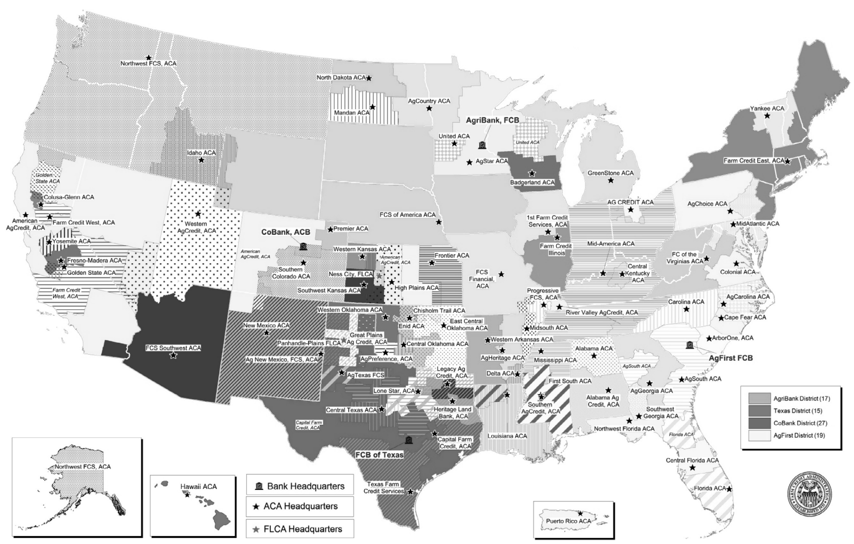
(as of 3/31/14)

Western AgCredit, ACA	0.5%		
Western Kansas ACA	0.0%		
Western Oklahoma ACA	0.0%		
Yankee ACA	0.7%		
Yosemite ACA	0.8%		

[1] Represents nonaccruals loans as a % of loans outstanding including accrued interest.

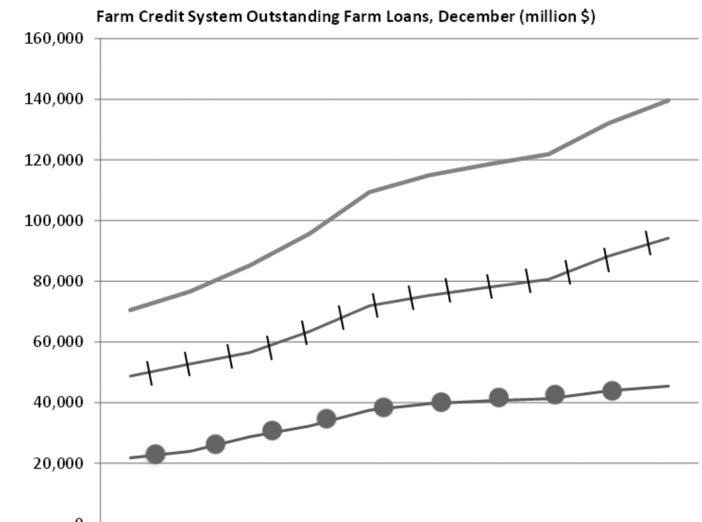
Farm Credit Institution Territories

ACAs & FLCAs by Districts (abbreviated names)



January 1, 2014

Trends in Farm Credit System Outstanding Farm Loans
Farm Credit System Outstanding Loans, December (million $)



	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Real estate mortgage loans	48,704	52,723	56,489	63,458	71,892	75,352	78,021	80,658	88,263	94,194
Production & intermediate-term loans	21,780	23,902	28,731	32,267	37,468	39,610	40,584	41,276	43,861	45,412
Total FCS Farm Loans	70,484	76,625	85,220	95,725	109,360	114,962	118,605	121,934	132,124	139,606

Source: FCS Annual Information Statements.

Percent Change from the Prior Year

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Real estate mortgage loans	4.8%	8.3%	7.1%	12.3%	13.3%	4.8%	3.5%	3.4%	9.4%	6.7%
Production & intermediate-term loans	3.4%	9.7%	20.2%	12.3%	16.1%	5.7%	2.5%	1.7%	6.3%	3.5%
Total FCS Farm Loans	4.4%	8.7%	11.2%	12.3%	14.2%	5.1%	3.2%	2.8%	8.4%	5.7%

Farm Credit System Loan Portfolio

(as of December 31, 2013)

	(in millions)	%
Agricultural related loans:		
Real estate mortgage loans	$94,194	46.8%
Production and intermediate-term loans	45,412	22.6%
Agribusiness loans	27,242	13.5%
Agricultural export finance	4,588	2.3%
Lease receivables	2,706	1.3%
Other	746	0.4%
s/t agricultural related loans	174,888	87.0%
Non-agricultural related loans:		
Rural residential real estate loans	6,557	3.3%
Rural utility [1]	19,615	9.8%
s/t non-agricultural related loans	26,172	13.0%
Total loans	$201,060	100.0%

[1] Represents energy loans, water/waste water loans, and communication loans.

In addition to participating in loans to eligible borrowers, FCS institutions have the authority to work with non-System lenders that originate "similar-entity" loans. A similar-entity borrower is not eligible to borrow directly from an FCS institution,

but because the borrower's operation is similar in function to that of an eligible borrower's operation, the System can participate in the borrower's loans (the participation interest must be less than 50 percent).

As of December 31, 2013, similar-entity lending accounts for approximately 5% of total System loans.

Of the 13% in non-agricultural related lending, 2% are similar-entity loans associated with rural utility lending.

More than 95% of similar-entity lending is associated with title II and title III lending authorities.

SUBMITTED LETTER BY KENNETH E. AUER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE FARM CREDIT COUNCIL

July 14, 2014

Hon. ERIC A. "RICK" CRAWFORD,
Chairman,
Subcommittee on Livestock, Rural Development, and Credit,
House Committee on Agriculture,
Washington, D.C.

Dear Mr. Chairman:

We applaud you and your colleagues on the Subcommittee for holding the recent hearing on credit availability in rural America. The Farm Credit System appreciated very much the opportunity to present testimony and to provide the Subcommittee our insights regarding rural credit conditions.

Unfortunately others appearing before the Subcommittee, specifically witnesses for the commercial banks, the American Bankers Association (ABA) and the Independent Community Bankers of America (ICBA), chose to provide testimony regarding the Farm Credit System that was highly inaccurate and deceptive. This letter addresses the most egregious inaccuracies in their testimony. We ask that it be made a part of the hearing record to ensure that those inaccuracies are not left unanswered on the record.

The Farm Credit System's Mission is to Be Agriculture's and Rural America's Customer-Owned Partner

As you may recall, questions were raised during the hearing regarding the mission of the Farm Credit System. The mission of the Farm Credit System was established by the Congress and is found in the Farm Credit Act of 1971, as amended. Congress stated it clearly in the opening clause of the Act, ". . . making credit available to farmers and ranchers and their cooperatives, for rural residences, and to associations and other entities upon which farming operations are dependent, to provide for an adequate and flexible flow of money into rural areas, and . . . to meet current and future rural needs."

The System's mission is to serve all types of agricultural producers who have a basis for credit, as well as others who help ensure that agriculture and rural America are economically successful. That includes farm-related businesses, rural homeowners, rural infrastructure providers including electric, telecommunications, water and waste as well as other entities. The System was not created to serve only young, beginning or small producers, as the bankers alleged. The Farm Credit Act specifically directs the System to serve all types of agricultural producers. In fact, it was almost 65 years after the System was established that language was added to the Farm Credit Act to require System lending associations to report on programs that focus on young, beginning and small farmers. The ABA and the ICBA continually and deliberately misstate the mission of Farm Credit System institutions including suggestions that Farm Credit institutions are supposed to be the lenders of last resort.

The institutions of the Farm Credit System comprise a borrower-owned, permanent system of credit for agriculture and rural America, just as intended by Congress and provided for in the Farm Credit Act. System institutions are doing what they are supposed to do when they compete with government-backed commercial banks in the marketplace and when they participate in loans with those same banks to support the rural economy.

Congress established the Farm Credit System and over the years expanded the operating authority of System institutions to compete effectively because farmers, ranchers and rural communities depend on timely and reliable access to capital and because it is well understood that government-backed commercial banks will seek to maximize profits in the face of limited competition.

Farm Credit Associations Have a Great Record of Serving Young, Beginning and Small Farmers and Are the Only Lenders Reporting on Actual Service

The bankers stated in their testimony that the data reported by Farm Credit institutions show that Farm Credit institutions are not making loans available to young, beginning and small farmers. This is inaccurate, and we are happy to correct the record.

The truth of the matter is that 83% of the loans made by Farm Credit institutions in 2013 were for less than $250,000. Almost 55% of all loans made were for $50,000 or less. Over 16% of the loans made by the System in 2013 were made to individuals 35 years old or less. This represents a great record of service since, according to the 2012 Agricultural Census, only 6% of principle farm operators are 35 years old or less.

The most relevant data for measuring service to these categories of borrowers is the number of loans made and the number of loans outstanding that support young, beginning and small farmers. The number of loans is the relevant data set instead of the percentage of total loan volume because the average loan size to young, beginning and small farms is naturally going to be smaller since in most cases their farming operations are smaller and can only support smaller amounts of debt.

Just over 40% of the number of new loans made by Farm Credit institutions in 2013 were made to borrowers that had less than $250,000 in gross sales from their farming operation. These are actual loans to small farmers. At the end of 2013, more than 49% of the total number of loans outstanding were made to individual farmers that had less than $250,000 in sales.

Even if you look at the volume of loans outstanding, the portfolio of the System reflects what is happening in agriculture. A study by USDA's Economic Research Service released in April 2014[1] describes the overall percentage of debt held by various sized farm businesses. Using this analysis is somewhat complicated because USDA recently increased the income threshold in its definition for "small farm" to those with less than $350,000 of gross farm income[2] resulting in a larger number of farmers being included in the category. Farm Credit institutions have maintained their definition of small farmer at $250,000 of sales. According to the USDA study, small farmers using their broader definition held 27% of total farm debt. As of the end of 2013, 21% percent of the Farm Credit System's total loan volume was to farmers with $250,000 or less of gross farm sales—and this was in a year of high commodity prices that drove up the number of farmers with gross farm sales that exceeded $250,000.

Farm Credit institutions are the only lenders that collect data on their lending to young, beginning and small farmers. Farm Credit institutions know how well they are serving these farmers and ranchers and are very proud to talk about it. Commercial banks do not collect similar data on whom they serve in agriculture. The ABA often reports on "small farm loans" made by banks. In fact, what they are reporting on is the size of loans made not whether the borrower's operation is small or large. Small loans are often made to large farmers. The commercial bank data provides very little information regarding their service to small farmers. Commercial banks do not track whether those "small farm loans" actually are made to small farmers, large farmers, beginning farmers, retired farmers or any other type of farmer since they are not required to collect the same types of data required of Farm Credit institutions. Because Farm Credit institutions collect this data, they know the types of borrowers to whom they are lending. In fact, and they are required to report on this annually to the Farm Credit Administration which reports the collective data to the Congress and posts it on their website.

Do Farm Credit institutions make and participate in large loans? Of course they do. The reality of modern agricultural production and the modern rural economy requires that large loans be made to finance successful projects and businesses that create jobs and provide for the quality of life in rural America. It takes a lot of capital for rural infrastructure providers to deliver services in rural communities. Agricultural cooperatives and other agribusinesses that store or add value to the agricultural products of farms or that provide necessary inputs to farmers have substantial capital needs.

Most commercial-sized farming operations, which produce the majority of our food and fiber, require substantial credit. Even a modest 15 acre pick-your-own strawberry operation requires credit that can exceed a million dollars, between land,

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[1] *Debt Use by U.S. Farm Businesses, 1992–2011;* USDA/ERS Economic Information Bulletin Number 122; Jennifer Ifft, Amirdara Novini, Kevin Patrick. April 2014

[2] *http://www.ers.usda.gov/amber-waves/2013-may/the-revised-ers-farm-typology-classifying-us-farms-to-reflect-todaysagriculture.aspx#.U7rXz7cU_cs.*

equipment, plant purchases and soil requirements. According to the USDA/ERS analysis, large-scale family farms that produced close to 40% of all agricultural production in 2011 had average agricultural debt that exceeded $1.1 million per family farm. Adequate supplies of competitively priced credit are the lifeblood of the rural economy and Congress charged Farm Credit institutions with the mission of helping to ensure that supply is always available irrespective of market conditions.

Every Financial Institution Must Have a Liquidity Line

Liquidity is the lifeline for financial institutions. Every commercial bank and credit union in the U.S. has access to government-backed liquidity. This became very evident in 2008 and 2009 when financial markets were seizing up due to the debacle that was created, for the most part, by banks in the mortgage markets. In excess of a trillion dollars of liquidity backed by taxpayers was pumped into the commercial banking sector. Having a Federal liquidity line backstop is so important that the American Bankers Association, undeniably no friend to credit unions, submitted a comment letter to the National Credit Union Administration in 2012 commenting on the importance of Federal backstops for liquidity. They stated, "ABA also believes that access to Federal liquidity backstops is part of any sound liquidity risk management program." [3] Their "belief" apparently stops before it applies to the Farm Credit System.

Farm Credit System institutions were the only U.S. financial institutions without a direct Federal backstop ensuring continued access to funding. In fact, the Farm Credit System is the only Government Sponsored Enterprise (GSE) that does not have a direct statutory backup line of credit with the Treasury.

When the world financial markets collapsed in 2008, the Farm Credit System could only access short-term debt in the financial markets. The System could not sell longer term paper. The market for that had disappeared virtually overnight. System institutions had to change the tenor of loans they could offer farmers and other customers, not because of anything the Farm Credit System had done—such as being a greater risk due to credit losses or diminished capital strength—but because of the fallout from the bad behavior of others.

The leadership of the System realized that such a situation was at odds with the Congressionally mandated mission to ensure credit availability for agriculture and rural America. Discussions were held with the Federal Reserve and the Department of Treasury. The Farm Credit System Insurance Corporation (FCSIC) initiated an interagency discussion with Treasury and the Federal Financing Bank (FFB) to explore whether the FFB could provide liquidity under exigent circumstances to support FCSIC in fulfilling its responsibility to see that investors in System debt are repaid in a timely manner. The goal was to provide liquidity in the event that financial markets completely stopped working and only after the assets of the Insurance Fund and other System liquidity had been committed.

It is important to differentiate between a liquidity line and other types of Federal backstop. The liquidity line provided to FCSIC is limited to providing access to capital when the funding markets are somehow compromised. The liquidity line is not accessible for Farm Credit if the System is experiencing financial stress that makes FCS bonds unattractive to investors. The FCSIC/FFB agreement makes clear that any funds provided would be temporary in nature and provided only to ensure that the System can continue to meet its obligations until normal financial market conditions return.

Both ABA and ICBA raised misleading questions about this interagency agreement in their testimony. ABA went so far as to suggest that the Farm Credit System is "increasing its dependence upon the U.S. Treasury" and that taxpayers "deserve a better understanding of what transpired between the Farm Credit System and the U.S. Treasury last September." ICBA stated that, "the FCA and FCS desired to lower their borrowing costs even further by acquiring this line of credit." Both characterized this as some sort of secret arrangement. None of these are accurate and appear intended to mislead the Subcommittee.

The agreement between FCSIC and the FFB was the subject of briefings with key members of the Agriculture Committees. The existence of the liquidity agreement has been consistently disclosed to the public by the System [4] and FCSIC has simi-

[3] Page 3, ABA letter to Mary Rupp, Secretary of Board, National Credit Union Administration, August 7, 2012; *Maintaining Access to Emergency Liquidity.*

[4] See Federal Farm Credit Banks Funding Corporation (FFCBFC) Third Quarter 2013 Information Statement page XXX and the 2013 FFCBFC Annual Information Statement, Page 71; both accessible through *www.farmcreditfunding.com.*

larly disclosed it publicly in its annual report that is available to the public as well.[5] Both the ABA and ICBA are attempting to make an issue out of an action taken by a Federal agency to address something administratively that needed no Congressional action to resolve and something that every commercial bank already has in place to a greater extent than the Farm Credit System. This was not an attempt to lower the cost of funds or to become dependent on the Treasury. This was a very responsible risk-mitigation arrangement undertaken by two Federal agencies. ABA and ICBA have sought to paint it as some sort of sinister plot, while failing to inform the Subcommittee regarding the extensive Federal liquidity backstop commercial banks have.

Commercial Banks Are Subsidized and Backed by Taxpayers—Farm Credit Brings the Benefit of Its GSE Status to Agriculture and Rural America, While Not Operating at Taxpayer Expense

Both ABA and ICBA frequently make the assertions that the institutions of the Farm Credit System operate at "taxpayer expense" and that because the System has access to government sponsored enterprise (GSE) funding, that System institutions harm community banks by providing competitive rates for agriculture. The Farm Credit System does not operate at taxpayer expense. System institutions are privately owned by the farmers, ranchers, agricultural cooperatives and others in rural America that borrow from them. The Farm Credit System even pays for the cost of the independent Federal regulatory agency that examines System institutions and writes the regulations that govern the operations of Farm Credit System institutions. In addition, System institutions support their own insurance fund that protects investors that buy System consolidated notes and debentures used to fund credit operations. Unlike commercial banks, System institutions do not borrow from the Federal Reserve. As a GSE System institutions obtain their loanable funds by issuing paper to the private financial markets. This access to dependable funding is essential to the ability of the System to fulfill its mission, and no taxpayer dollars are directly involved.

GSE funding is by no means exclusive to the Farm Credit System. Commercial banks have direct access to GSE funding as well. Commercial banks obtain GSE funds through Fannie Mae and Freddie Mac. They have direct access to GSE funds through Farmer Mac for agricultural lending activities. Commercial banks even own their own GSE, the Federal Home Loan Bank System, which provides commercial banks advances of GSE funds for housing, small business and agricultural lending as well as pays them the extra bonus of patronage based on their use of Home Loan Bank advances. The Federal Home Loan Banks that are owned by the banks are fully tax-exempt. Banks also have direct taxpayer backing on the major source of their loanable funds through the Federal Deposit Insurance Corporation (FDIC). Thomas Hoenig, the vice-chairman of the FDIC, recently noted his view that, "the government safety net of deposit insurance, central bank loans, and ultimately taxpayer support provides a multibillion dollar subsidy to commercial banks . . ."[6]

The size of the Federal safety net for commercial banks is substantial. In 2010, the Federal Reserve Bank of Richmond published a paper that focused on identifying the extent of taxpayer backing for financial institutions. The paper notes a distinction between certain liabilities of commercial banks that are "explicitly guaranteed" by taxpayers and those of GSEs that are "implicitly guaranteed."[7] The estimates of the level of direct taxpayer explicit guarantee for commercial banks and savings firms was updated in a follow up study published in 2013 using data available through the end of 2011. They found that the explicit Federal guarantee for commercial banks and savings firms had grown to a staggering $7.156 trillion at that time.[8] It is unfortunate that the facts get in the way of the picture that the ABA and ICBA want to paint, but the facts are clear that commercial banks have far more taxpayer backing than does Farm Credit.

Farm Credit institutions do have the benefit of specific tax treatment that helps them provide long-term mortgage credit to farmers and ranchers across the U.S., but Farm Credit institutions are not tax-exempt entities. Corporate taxes are paid by Farm Credit institutions on income derived from short and intermediate term loans, and loans made under title III of the Farm Credit Act to cooperatives, rural utilities, *etc.* As cooperatives, System institutions also distribute patronage to the

[5] See FCSIC Annual Report for 2013, page 9, available at *www.fcsic.gov.*

[6] *http://www.fdic.gov/about/learn/board/hoenig/govsubsidy.pdf.*

[7] *How Large Has the Federal Financial Safety Net Become?* Nadezhda Malysheva and John R. Walter, FEDERAL RESERVE BANK OF RICHMOND, ECONOMIC QUARTERLY—Volume 96, Third Quarter 2010, pages 273–290.

[8] *https://www.richmondfed.org/publications/research/special_reports/safety_net/pdf/safety_net_methodology_sources.pdf.*

farmers and cooperatives that own those institutions. Those owners pay ordinary income tax on that patronage. Subchapter S commercial banks, which make up the majority of agricultural banks, pay little to no Federal tax at the institution level for income derived from all of their business. Like cooperatives, taxes are paid by the owners on the bank profits that are directly passed through to those owners, but since these taxes are paid by the owners, and not by the bank itself, Federal tax obligations do not impact on the ability of these institutions to price products competitively. The reality is commercial banks have considerable direct backing by taxpayers.

Farm Credit System Lending Improves Credit Availability in Rural America

The existence of the Farm Credit System in the agricultural credit markets does not harm commercial banks as they suggested in their testimony. ICBA relies on surveys of their own members—commercial banks—to conclude that the System is adversely affecting bankers. Anecdotal stories from bankers hardly qualify as evidence of harm. Surveys of Farm Credit institutions would conclude the same thing—that System institutions lose credits to bankers all the time as well. What is playing out is competition. The beneficiaries of this competition are farmers and ranchers across the U.S. It results in agriculture having access to competitive rates and terms for an input critically important for the success of today's farming operations.

Ask farmers or rural business owners if they are better off having one, two or more lenders competing for their business. We all know that asking bankers this question will result in a different answer. There is limited credibility, if any, in the ICBA survey of bankers other than to provide a picture painted by bankers eager to minimize their competition and maximize their profits.

An interesting study conducted by two Iowa State economists in 2005 noted that commercial banks in rural communities in the Midwest may be focusing too much on agricultural credit to the detriment of Main Street. They noted that, "banks that specialize in farm lending are more profitable," but that "agricultural credit demands may crowd out nonfarm demands for bank loans in farming-dependent rural areas." They also noted that, "Price discrimination and barriers to entry may result in less credit being extended in rural areas than is optimal."[9] The point of this is the exact opposite that the ICBA bankers would have you believe—competition in credit markets is a good thing. Both banking organizations failed to mention that the real challenge for smaller banks is not the Farm Credit System but broader competition from larger banks.[10]

"Similar-Entity" Lending Helps Farm Credit Partner with Commercial Banks and is Consistent with the Intent of Congress

Both the ABA and the ICBA have pointed to several recent lending transactions that Farm Credit System institutions have participated in and suggested that those are "illegal" and inconsistent with what the Farm Credit Act allows. These transactions are not illegal and are specifically provided for in the Farm Credit Act. Further, they are exactly what the Congress contemplated when the authority to engage in these types of transactions was provided to the System in 1992 as a part of the Farm Credit Banks and Associations Safety and Soundness Act of 1992, P.L. 102–552 and then expanded in 1994 in the Farm Credit System Agricultural Export and Risk Management Act of 1994, P.L. 103–376.

In providing this authority to the System, the Congress recognized the growing capital needs of agriculture. The Congress noted at that time that in order for those needs to be met, Farm Credit System institutions and commercial banks would need to work together by sharing participations in loans back and forth to spread risk and continue to make the capital available to agriculture and rural America that is vital to its continued economic growth. The ABA and ICBA may want to rewrite history to fit their own goals, but the words spoken by the leaders in the Senate upon final passage of the 1994 legislation that expanded the similar-entity lending authority within the Farm Credit System are the ones that matter in explaining this authority.

Senator Patrick Leahy described these provisions as follows, "The Act will accomplish something additional that I believe both the Farm Credit System and private

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[9] *Are Rural Credit Markets Competitive? Is There Room for Competition in Rural Credit Markets?* Maureen Kilkenny and Robert W. Jolly; CHOICES MAGAZINE; 1st Quarter 2005, pages 25–29.

[10] *Agricultural Lending Shifts to Large Banks,* Nathan Kaufman and Maria Akers, AGRICULTURAL FINANCE DATABOOK, Federal Reserve Bank of Kansas City, July 2013.

banks have been seeking for some time and will find mutually beneficial. It creates the opportunity for farm credit institutions and private banks to manage and reduce their concentration of loan loss risk in terms of geography, industry, and account exposure by expanding the System's ability to purchase and sell loan participations from commercial banks and other non-System lenders."[11]

Senator Lugar added to Senator Leahy's explanation providing additional detail regarding how this authority would help the Farm Credit System manage the risk associated with the large loans it was involved with to support agriculture and rural America. Senator Lugar said, ". . . these changes will enhance the System's ability to reduce its concentration of risk in terms of geography, industry, and account exposure. System institutions both purchase and sell participations from and to other lenders, a practice that is important particularly in the case of larger loans. For example, CoBank recently administered a $650 million syndication for Farmland Industries, Inc., a major farmer-owned marketing and supply cooperative. Seven commercial banks joined CoBank to provide funding for the syndication, illustrating the growing number of cases where banks and System institutions are working together harmoniously to meet the credit needs of rural America."

Lugar went on to say, "It is important to note that the legislation will not give System institutions an unfair advantage over the commercial banking industry. For example, in the case of loans to agricultural entities that are similar to System borrowers, the System would be prohibited from providing 50 percent or more of the funds for such loans, ensuring that the System's use of loan participations will be limited to those cases where commercial lenders desire to involve the System, and that the System still will not be able to originate loans of this type."[12]

As noted by Senator Lugar, the similar-entity lending authority contains very specific limitations regarding the ability of the System to hold a majority of one of these loans and the ability of the System to have these types of transactions to be a major portion of its total assets. The law limits these to no more than 15% of total assets of the participating System institution. The ABA and ICBA should stop their disinformation efforts regarding these transactions and instead embrace, as their own members have done, the opportunity to work with Farm Credit institutions to enhance the agricultural and rural economy.

Focus of Financial Institutions Should be on Improving Rural Economy

The Farm Credit System on a daily basis works with commercial banks across America. In addition, when Farm Credit provides financing for a rural electric cooperative, a rural water system, a rural telephone company, an agricultural cooperative, and to individual farmers and ranchers, all of this activity is enhancing the rural economy. The Farm Credit System allows rural areas to benefit from both national and international capital markets by moving this capital efficiently from those national markets into rural communities.

The credit needs in rural America are greater than either the commercial banks or the Farm Credit System can alone finance. We would welcome a discussion on how Farm Credit and commercial bankers can work together even more to improve the rural economy.

Thank you and the Subcommittee for your efforts on behalf of agriculture and rural America.

Sincerely yours,

KENNETH E. AUER,
President and CEO.

SUBMITTED LETTER BY JO ANN EMERSON, CHIEF EXECUTIVE OFFICER, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

July 3, 2014

Hon. ERIC A. "RICK" CRAWFORD,
Chairman,
Subcommitte on Livestock, Rural Development, and Credit,

Hon. Jim Costa,
Ranking Minority Member,
Subcommittee on Livestock, Rural Development, and Credit,

[11] Senator Leahy, Page S14235, *Congressional Record,* October 5, 1994.
[12] Senator Lugar, Page S14235, *Congressional Record,* October 5, 1994.

House Committee on Agriculture,
Washington D.C.;

House Committee on Agriculture,
Washington D.C.

Dear Chairman Crawford and Ranking Member Costa:

On behalf of the National Rural Electric Cooperative Association (NRECA), thank you for the opportunity to submit a letter as part of the record for your Subcommittee's June 25, 2014 hearing about credit availability in rural America. As the trade association representing the nation's more than 900 rural electric cooperatives which serve over 42 million Americans in 47 states, NRECA understands that the availability of credit in rural America is absolutely critical to our rural electric consumer owners and their communities. NRECA appreciates the Subcommittee's consideration of our perspective.

Rural electric cooperatives often serve as the hub for economic development in their community. Working with other businesses, local government officials, and community leaders, our members seek to constantly improve the quality of lives of their members. One way they do this is to invest in upgrading their electric infrastructure to create jobs and improve the delivery of affordable, reliable electricity. Key to this investment is the availability of capital for the cooperatives.

Electric cooperatives' unique business model as not-for-profit, member-owned electric utilities have driven their emergence as leaders in developing innovative financial solutions for rural America. In 2007 we approached the Congress with a unique concept that would allow rural electric cooperative borrowers to benefit from the secondary market activities of the Federal Agricultural Mortgage Corporation, also known as Farmer Mac. The idea was to allow Farmer Mac to use its established access to the capital markets to lower interest costs on rural electric cooperative loans similar to the way it already did for agricultural real estate loans. By lowering interest costs on rural electric loans, the rural electric cooperatives were able to pass those savings on to your constituents and thereby make available more dollars in the local economies. Congress acted on our request in the 2008 Farm Bill and expanded Farmer Mac's charter to allow authorized secondary market activities for electric cooperative loans made by lenders organized as cooperatives such as our sister cooperative, the National Rural Utilities Cooperative Finance Corporation (CFC).

We are pleased to report that this action by Congress had a profound effect. Since Farmer Mac first began participating in the rural electric lending sector, Farmer Mac has worked to provide more than $5 billion of capital to rural America through secondary market purchases of electric co-op loans and securities. Through our relationship with Farmer Mac, NRECA member cooperatives have been able to diversify their funding sources and add an important liquidity management tool, as Farmer Mac provides CFC with access to external financing beyond CFC's own offerings of securities in the capital markets. As not-for-profit cooperatives, the rural electric cooperatives pass these savings on directly to their consumer owners, allowing your constituents to continue to receive affordable and reliable electric power along with upgraded facilities.

Rural electric systems currently serve approximately 42 million Americans or 12 percent of all consumers of electricity in the United States and its territories. The provision in the 2008 Farm Bill that expanded Farmer Mac's authorities has directly benefitted these rural communities that you and we serve. The resulting innovative partnership between Farmer Mac and the rural electric cooperatives allows NRECA to better meet the financial needs of its members and allows Farmer Mac to further support rural communities in fulfillment of its mission. Farmer Mac's ability to provide electric cooperatives with a stable and reliable source of credit, as well as liquidity and lending capacity that will help stimulate economic growth and job creation in the rural communities is extremely helpful and appreciated.

Sincerely,

JO ANN EMERSON, *CEO,* NRECA.

SUBMITTED LETTER BY SHELDON C. PETERSEN, CHIEF EXECUTIVE OFFICER, NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION (CFC)

July 8, 2014

Hon. ERIC A. "RICK" CRAWFORD,
Chairman,
Subcommittee on Livestock, Rural Development, and Credit,

House Committee on Agriculture,
Washington, D.C.

Chairman Crawford, Ranking Member Costa, and Members of the Subcommittee:

On behalf of the National Rural Utilities Cooperative Finance Corporation (CFC), thank you for the opportunity to comment following your Subcommittee's June 25, 2014, hearing on credit availability in rural America. As the only lender created and owned by America's electric cooperative network, CFC plays an important role in providing credit to rural America, and we appreciate the Subcommittee's consideration of our perspective.

CFC, a nonprofit finance cooperative, was organized by local, consumer-owned and controlled electric cooperatives in 1969 in response to their growing need for capital. Initially, rural electric cooperatives formed CFC as a source of available financing to supplement loan programs administered by the Rural Utilities Service of the United States Department of Agriculture. Today, CFC is owned by more than 1,000 electric cooperative organizations in 48 states and continues providing members with flexible financial products and services.

Since its creation 45 years ago, CFC has provided billions in direct funding to the nation's rural electric cooperatives, and we continue to work to bring them low-cost private capital so they can acquire, construct, and operate electric distribution, generation, transmission and related facilities. The ultimate beneficiaries of CFC's lending activities are rural electric consumers, the communities served by rural electric cooperatives, and the nation as a whole.

In CFC's role as a lender to rural electric cooperatives, we are continually looking for new opportunities to serve our member-owners' evolving needs. By providing a secondary market for loans to rural electric cooperatives, the Federal Agricultural Mortgage Corporation (Farmer Mac) is helping us fulfill this mission.

In the 2008 Farm Bill, Congress acted on the request of our national trade association, the National Rural Electric Cooperative Association (NRECA), to provide clear authority for Farmer Mac to invest in rural utility loans in much the same manner as they already did for agricultural real estate loans. Specifically, Congress revised Farmer Mac's charter to authorize secondary market activities loans to electric cooperatives made by lenders organized as cooperatives, such as CFC. The rationale for this proposal was that Farmer Mac could use its established access to the capital markets to provide additional liquidity to rural utility lenders and also potentially lower interest costs on rural electric cooperative loans with the resulting savings ultimately passed through to rural electric consumers.

We are pleased to report that this action by Congress and the relationship with Farmer Mac has produced an important liquidity management tool and has helped CFC diversify its funding sources. This allows CFC to offer additional capital for lower-cost financing in many cases, directly benefiting the nation's electric cooperatives by ensuring they can deliver safe, reliable and affordable electric power to folks no matter where they may live.

Today, electric cooperatives currently serve approximately 42 million Americans, or 12 percent of all consumers in the United States and its territories. The changes Congress enacted in the 2008 Farm Bill that expanded Farmer Mac's authority directly benefit rural communities that you represent. The resulting innovative partnership with Farmer Mac enables CFC to better meet the financial needs of its members and allows Farmer Mac to further support rural communities.

Together, Farmer Mac and CFC provide electric cooperatives with a stable and reliable source of credit, as well as liquidity and lending capacity that stimulates economic growth and job creation across rural America.

Sincerely,

Sheldon C. Petersen

SHELDON C. PETERSEN,
CEO.

SUBMITTED LETTER BY BRAD THALER, VICE PRESIDENT OF LEGISLATIVE AFFAIRS, NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

June 24, 2014

Hon. ERIC A. "RICK" CRAWFORD,	Hon. Jim Costa,
Chairman,	*Ranking Minority Member,*

Subcommitte on Livestock, Rural Development, and Credit,
House Committee on Agriculture,
Washington D.C.;

Subcommittee on Livestock, Rural Development, and Credit,
House Committee on Agriculture,
Washington D.C.

Re: Credit Availability in Rural America

Dear Chairman Crawford and Ranking Member Costa:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's Federal credit unions, I write today in conjunction with tomorrow's hearing entitled "A review of credit availability in rural America." As you are aware, in many rural areas of the country, there are a limited number of financial institutions providing agricultural lending. Credit unions are proud that they have been making safe and affordable agricultural loans for a number of years, including through the economic crisis.

As the Subcommittee considers the issue of credit availability in rural America, we urge you not to overlook the potential that currently exists to do more with our nation's credit unions. Our nation's credit unions have money to loan to small businesses; however, an outdated and arbitrary business lending cap stands in their way. Representatives Ed Royce and Carolyn McCarthy have introduced the *Small Business Lending Enhancement Act* (H.R. 688), a bill that would raise the member business lending cap in a sound way for eligible credit unions and help extend credit to the small businesses that drive our economy without spending a dime of taxpayer funds. We urge you to support this effort.

Additionally, while the National Credit Union Administration (NCUA) took action in 2012 to help credit unions do more to serve low-income and rural areas, recent actions by the agency could hamper that availability of credit. In January of this year, the NCUA issued a proposed risk-based capital rule for credit unions. If implemented as proposed, the new rule could have a chilling effect of reducing lending in rural areas as the agency's proposed "risk-weights" for member business loans may negatively impact the ability of credit unions to provide agricultural loans to their members. Several Members of Congress have already weighed in with their concerns about the proposal's potential negative impact on agricultural and rural lending. We would urge the Subcommittee to follow developments on this issue as well.

We would welcome the opportunity to discuss these issues further. If my colleagues and I can be of assistance to you, or if you have any questions regarding this issue, please feel free to contact myself or NAFCU's Director of Legislative Affairs, Jillian Pevo, at [**Redacted**].

Sincereley,

BRAD THALER,
Vice President of Legislative Affairs.

CC: Members of the Subcommittee on Livestock, Rural Development, and Credit.

SUBMITTED STATEMENT BY NATIONAL ASSOCIATION OF REALTORS®

Introduction

The National Association of REALTORS® (NAR) offers this statement on the importance of access to credit in rural areas. NAR represents a wide variety of housing industry professionals committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential American households. The Association has a long tradition of support for innovative and effective Federal housing programs and has worked diligently with the Congress to fashion housing policies that ensure Federal housing programs meet their missions responsibly and efficiently.

Prospective homebuyers nationwide have found significant barriers to obtaining mortgage financing. Credit standards remain very tight, and those wishing to purchase a home—especially first-time buyers—are facing many obstacles to finding a safe, affordable home loan. The situation is especially difficult in rural areas, where rental housing is often lacking and access to mortgage finance is challenging. Nearly all of the counties with the highest poverty rates in America are rural. The lack of multi-family and other rental units in rural communities means families have few options other than to purchase a home. As a result, access to safe, affordable mort-

gage financing is important in these areas. NAR thanks you for holding this hearing to discuss these issues.

Housing in Rural Communities

Nearly 20 percent of the U.S. population lives in rural areas or small towns. Many jobs in these communities are low-wage, and incomes in rural areas are often lower than national averages. According to the U.S. Census, the number of rural citizens living in poverty increased to 8.5 million in 2012, from 8.0 million in 2011. Overall, in 2012, rural median household incomes ($41,198) were about 20 percent lower than national median household incomes ($51,017) and 22 percent less than median urban household incomes ($52,988).[1]

Housing conditions in rural areas can be inferior to homes in urban or suburban neighborhoods. Housing choices can be limited due to differences in infrastructure requirements, lack of public transit, and access to other amenities. The availability of rental housing is often scarce. The approximately 7.1 million renter-occupied units in rural communities comprise only 28.4 percent of the rural and small town housing stock.[2]

The lack of rental housing means homeownership is frequently the only option for rural families. Although homeownership rates are higher in rural areas than the national average, many rural families face significant obstacles in finding safe, affordable, decent housing. According to a report by NeighborWorks, in rural areas, "the housing stock itself varies as greatly as the character of rural areas, but two common trends are that (1) it is overwhelmingly comprised of single-family homes; and (2) a higher percentage of the stock is in substandard condition compared to metropolitan areas."[3]

These findings make it even more important to help rural families find quality housing.

Federal Housing Programs

Federal housing programs are instrumental in providing affordable housing opportunities to low- and moderate-income rural homebuyers. The National Association of REALTORS® strongly supports Federal housing programs that target rural communities and provide sufficient Federal assistance needed to meet the housing needs of rural communities.

The Rural Housing Service (RHS) 502 loan program provides opportunities for homeownership for these families. In FY 2013, the RHS helped nearly 170,000 rural American families become homeowners, nearly 80 percent of whom were first-time homebuyers. The program includes guaranteed and direct loans. Section 502 loans can be used to build, repair, renovate or relocate a home, or to purchase and prepare sites, including providing water and sewage facilities. The guaranteed loans are funded by private lenders and insured by the RHS.

In many rural communities, the Section 502 direct loan program is the only housing assistance available. Section 502 homeownership direct loan program loans are used primarily to help low-income households purchase homes. These loans may also be used to refinance debts when necessary to avoid foreclosure, or when required to make necessary house repairs affordable. NAR strongly supports the availability of sufficient Federal resources to ensure the Section 502 direct loan program responsibly addresses the housing needs of low- and moderate-income[4] rural families.

In recent years, the Section 502 program has been in jeopardy of depleted funding or commitment authority before the end of the fiscal year. NAR would encourage Congress to provide adequate funding and commitment authority to meet the needs of rural communities.

It also should be noted that FHA is also a very valuable program for families living in rural areas. Some homes, due to their rural nature, do not meet FHA standards and are more appropriately suited to the programs of the RHS. But for others, FHA has been a very important option for home buying families. FHA provided the majority of mortgage financing options during the housing crisis, and continues to be a critical tool for affordable, safe housing. FHA's countercyclical role allowed

[1] *Income, Poverty, and Health Insurance Coverage in the United States: 2012,* Issued September 2013, By Carmen DeNavas-Walt, Bernadette D. Proctor, Jessica C. Smith, p. 60–245.

[2] Housing Assistance Council, *Taking Stock: Rural People, Poverty And Housing In The 21st Century,* December 2012.

[3] *Landscapes of Foreclosure: The Foreclosure Crisis in Rural America,* Adam Wodka, The Edward M. Gramlich Fellowship in Community Development, November 2009.

[4] At least 40 percent of appropriated Section 502 direct loan funds must be used to assist families with incomes less than 50 percent of area median income (AMI).

more than four million families to purchase a home during the height of the economic crisis.

Suggestions To Expand Access

Update Definition

NAR was pleased that Congress approved language as part of the farm bill to grandfather existing communities currently participating in the RHS programs as eligible for continued participation. Without that language, more than 900 communities would have lost access to these valuable housing programs. The definition of "rural" used by RHS has not been changed since 1974, despite the rapidly changing demographics of our country. The existing definition requires communities to: (1) be outside of a metropolitan statistical area (MSA), (2) be "rural in character", (3) have a serious lack of mortgage credit, and (4) have a population under 20,000. Communities and populations have changed dramatically in the last 80 years. Relying on a decades old definition is unrealistic and won't meet the needs of rural communities. NAR urges Congress to look at ways to update this definition, and ensure that our rural communities have access to the programs they need.

Direct Endorsement for 502 Guaranteed Loans

RHS has proposed language to make the Section 502 Guaranteed loan program a direct endorsement program. Today, every loan must be approved by staff of the Rural Housing Service. In recent years, staffing has been dramatically reduced, and borrowers are now experiencing significant delays in loan approval. Both the Veterans Affairs loan guaranty and the FHA mortgage insurance program utilize private landers for direct endorsement. Adding RHS to this list would create great efficiencies for the Service and for homebuyers. RHS, in turn, would have additional staff time to focus on a strengthened lender monitoring process and risk management. We strongly urge Congress to provide RHS with direct endorsement authority to ease burdens on the agency and accelerate processing for borrowers.

Resist Calls To Limit Access

Since the beginning of the economic recovery, there have been calls to restrict the role of the Federal Government in housing programs. Both RHS and FHA have been shown to provide great benefits to American families, and our economy as a whole. Since its inception in 1949, RHS has provided more than 3.69 million families with the ability to obtain the dream of homeownership. FHA was a driving force pulling our nation out of the economic recession. Moody's has estimated that without FHA's role during the housing crisis, housing prices would have dropped an additional 25 percent, and American families would have lost more than $3 trillion of home wealth.

These programs offer significant benefits to American families, with little cost to the taxpayer. Changes to these programs should only be made to enhance access for more qualified buyers. NAR strongly opposes any changes that further constrain mortgage financing.

Conclusion

Rural families face unique challenges in accessing mortgage credit. NAR encourages you to consider changes to programs that will make it easier for these families to obtain safe, affordable, decent homes in the communities in which they chose to live, and looks forward to working with you to achieve that goal.

SUBMITTED QUESTIONS

Response from Hon. Jill Long Thompson, Ph.D., Board Chair and Chief Executive Officer, Farm Credit Administration

Questions Submitted by Hon. Collin C. Peterson, a Representative in Congress from Minnesota

Question 1. You mentioned the Farm Credit System Insurance Fund currently holds more than $3.6 billion. Can you walk me through the structure of the Insurance Fund and provide more detail on its creation during the credit crisis of the late 1980s? Is it part of the Farm Credit Administration or a separate entity?

Answer. In the Agricultural Credit Act of 1987, Congress established the Farm Credit Insurance Fund to provide insurance for the timely payment of principal and interest on obligations issued on behalf of Farm Credit System (System) banks.

In the 1987 Act, Congress also established the Farm Credit System Insurance Corporation (FCSIC), which administers the Fund. FCSIC sets and assesses the premiums that System banks must pay into the Fund. Money in the Fund that is not

being used must be invested in obligations of the United States or in obligations guaranteed as to principal and interest by the United States.

In addition to using the Fund to insure timely payment of principal and interest on System-wide and consolidated debt, FCSIC must use the Fund to ensure the retirement of protected borrower stock at par value.

FCSIC may also use the Fund to cover its operating costs and provide assistance to troubled System banks and associations. In addition, if the Farm Credit Administration (FCA) places a System bank or association in conservatorship or receivership, FCSIC must act as the conservator or receiver.

As a former Member of the U.S. House of Representatives, having served on the Agriculture Subcommittee with jurisdiction over credit from 1989 to 1995, I believe the statute implies the Farm Credit System Insurance Corporation is part of the Farm Credit Administration. More significantly, the language of the statute makes it clear that FCSIC as an entity was not intended to be an additional cost for the Farm Credit System and the farmers and ranchers it serves. The Farm Credit Act directs FCSIC to carry out its role using the staff, examination information, and other resources of FCA whenever possible.

By statute, FCSIC is a U.S. Government-controlled corporation "managed by a Board of Directors that shall consist of the members of the Farm Credit Administration Board . . . chaired by any Board member other than the Chairman of the Farm Credit Administration Board." In addition, "to the extent practicable, the Corporation shall use the personnel and resources of the Farm Credit Administration to minimize duplication of effort and to reduce costs."

Question 2. Testimony from the second panel mentions a $10 billion line of credit that was requested through the Treasury Department's Federal Financing Bank for the Farm Credit System Insurance Fund (FCSIC). Can you tell us more about the situation with the Insurance Fund and the letter of credit?

Answer. It is FCA's understanding that FCSIC entered into the agreement with the Federal Financing Bank to ensure "back-up" liquidity, up to $10 billion, for System banks in the event of a general market disruption. An advance from the Federal Financing Bank would not be available for deteriorating credit conditions in the Farm Credit System. Any advance from the Federal Financing Bank would be fully collateralized by the System. The agreement must be renewed annually.

Question 3. Were you aware of the Brookings Institution report commissioned by the Insurance Fund? This report goes into detail regarding the FCSIC discussions with the Federal Financing Bank. Were you aware whether this report was officially shared with the Committees of jurisdiction? Has the FCA taken a position on whether to ask Congress to reconsider if the structure set up in 1987 is adequate to handle extraordinary circumstances?

Answer. Yes, FCA was aware that FCSIC contracted with the Brookings Institution for the report, and we informed staff of the House Committee on Agriculture and the Senate Committee on Agriculture, Nutrition, and Forestry about the report, which was published on the Brookings website.

FCA has not taken a position on whether to ask Congress to reconsider the FCA/FCSIC structure as provided by Congress. The structure allowed for the agreement with the Federal Financing Bank, and this agreement should be adequate to handle the extraordinary circumstances of a liquidity crisis. Nevertheless, projecting the effects of the next crisis is very difficult.

In the wake of the volatile market conditions that began in 2008, FCA took a close look at whether the System could continue to fund borrowers under adverse market conditions unrelated to the agriculture economy. The System is the only federally chartered set of financial institutions that did not have a designated source of emergency funding in the event of a market shutdown.

Question 4. The issue of "cherry-picking" customers is raised in testimony from the second panel. Is there anything that a commercial bank can do if they feel that one of their customers has been enticed away by a lower interest rate? Is there anything in the Farm Credit Act or your regulations that prohibits this?

Answer. FCA is charged with ensuring the safety and soundness of the System. Part of this responsibility is to examine whether the System is appropriately pricing its loans. Our examiners regularly review loan pricing practices during examinations. We also review inquiries received from the public, including commercial banks.

Congress established the System for serving agriculture and rural America. Providing a stable and reliable funding source for that industry, in a safe and sound manner, and at competitive rates, helps ensure that the System fulfills that mission.

Three sections of the Farm Credit Act address loan pricing by the System under typical market conditions. Those sections are 1.8(b), 2.4(c)(2), and 3.10(a). Section

1.8(b) states, ". . . it shall be the objective to provide . . . credit . . . at the lowest reasonable costs on a sound business basis taking into consideration the cost of money to the bank, necessary reserve and expenses of the bank and associations, and providing services to members." Sections 2.4(c)(2) and 3.10(a) are consistent with section 1.8(b). Therefore, just as a money center bank or a medium-sized or community bank considers these factors in determining its rates, so must a System institution.

Contrary to some misunderstanding, section 1.1(c) of the Farm Credit Act does not prohibit System lenders from charging interest rates below other lenders. That provision was added to the Farm Credit Act in 1986 to prohibit System institutions from using special regulatory accounting practices to charge rates below the competitive market. The legislative history of the provision indicates that Congress did not intend the language in section 1.1(c) to be a provision of positive law or to constitute a formula for determining interest rates. (See the 1994 General Accounting Office report, "Farm Credit System Repayment of Federal Assistance and Competitive Position.") When this provision was added to the Farm Credit Act, it applied to those System institutions that were temporarily using regulatory accounting practices. Therefore, section 1.1(c) did not override sections 1.8(b), 2.4(c)(2), and 3.10(a) of the Farm Credit Act.

Question 5. There is a question of whether CoBank's loan to Verizon to buy-out Vodaphone's interest in Verizon Wireless was an eligible loan under the Farm Credit Act. Can you share with us the FCA's position on this?

Answer. CoBank, ACB, has authority to lend to entities providing telephone services in rural areas. Section 3.8 of the Farm Credit Act specifically provides CoBank with this authority, which includes rural wireless carriers. Over the past 25 years, CoBank was an early and active lender for many of the communications companies providing wireless telephone services in rural areas. With the evolution of the wireless industry, there has been continued consolidation, with smaller ventures, many financed by CoBank, being acquired by Verizon or other communications companies.

Further, under section 3.1 of the Farm Credit Act, Congress granted banks for cooperatives authority to participate in loans to "similar entities" for risk management purposes. A similar-entity is a party that is ineligible for a loan from the System but has operations that are functionally similar to the activities of eligible borrowers. To be considered a similar-entity, a party must derive a majority of its income from, or invest a majority of its assets in, the conduct of activities that are performed by eligible borrowers. Verizon Wireless has operations functionally similar to those of directly eligible rural wireless carriers.

The statute limits the System's similar-entity lending in a couple of ways. The Farm Credit Act requires non-System lenders to hold 50 percent or more of the principal amount of all similar-entity loans and restricts the cumulative amount of any System institution's similar-entity participations to 15 percent of its total assets. In addition, participations to a single credit risk cannot exceed ten percent of the institution's total capital. The System's involvement in the syndicated credit was well below the statutory limitations.

Loans to similar entities are multi-lender transactions often involving large companies. Before purchasing a similar-entity credit, the System institution must determine that the credit is within its similar-entity authorities and satisfies its credit underwriting standards. We review the System's participation in similar-entity credits.

Question 6. Can you explain to the Committee what the role is of the Farm Credit System institutions which are participating in loans, such as the Verizon Wireless buy-out, or in building a local hospital, another example raised in testimony?

Answer. System institutions participate in loans, as authorized by the Farm Credit Act, to diversify their loan portfolios and earnings. This enables them to meet their mission of providing a stable source of credit through good times and bad for farmers and ranchers, their cooperatives, and other agribusinesses and rural service organizations. The legislative history is clear that Congress expanded the System's lending authority to include similar entities as a means to provide the System with increased portfolio diversification.

Likewise, on a very limited basis, as authorized by FCA under pilot programs or case-by-case approvals, System institutions have used their investment authorities to make investments in rural communities. These investments include bonds that finance improvements to deteriorating rural hospitals, rural medical clinics, assisted-living facilities, and other rural infrastructure projects that are critical to the well-being of farmers and ranchers and their communities. They constitute less than two percent of the System's total assets.

These loan participations and rural investments are most often not completed in isolation, or in competition with local lending institutions, but rather in partnership with other local lending institutions, and many times in coordination with the USDA's Rural Development Agency.

Response from Chris Beyerhelm, Deputy Administrator for Farm Loan Programs, Farm Service Agency, U.S. Department of Agriculture

Question Submitted by Hon. Joe Courtney, a Representative in Congress from Connecticut

Question. The USDA Farm Service Agency guaranteed loan program is a very important program in my district. The program is used extensively by lenders in my District and across Connecticut. During the 2012 Farm Bill deliberations, I worked with Congressman Owens, then a Member of this Committee, to encourage language to be included in the farm bill that provides more flexibility for the types of business structures eligible for FSA loans and loan guarantees. Chairman Lucas and Ranking Member Peterson included this increased flexibility when drafting the farm bill this Congress.

We have had situations where family farms that are structured as family trusts and Limited Liability Companies were not eligible for FSA guarantees. Could you check on the status of implementation of these farm bill provisions and report back to my office?

Answer. The provisions you mentioned are included in sections 5001, 5002, 5101, and 5201 of the 2014 Farm Bill. To implement these sections as quickly as possible, FSA is using an expedited rule making process and plans to publish an interim rule that will become effective upon publication. The *Federal Register* document has been drafted and is currently in clearance. FSA anticipates publication of the interim rule this fall. In the meantime, FSA is developing training materials and other guidance for employees and customers to help ensure effective implementation.

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